

AD-A246 599



NAVAL POSTGRADUATE SCHOOL

Monterey, California

2



THESIS

POTENTIAL IMPACT OF THE ELIMINATION OF THE M
ACCOUNT ON THE DEPARTMENT OF THE NAVY

by

Ben A. Fegurgur
and
Anthony F. Marinello

December 1991

Thesis Advisor:

Professor Richard A. Harshman

Approved for public release; distribution is unlimited

92 2 20 004

92-04999



REPORT DOCUMENTATION PAGE

1a. REPORT SECURITY CLASSIFICATION Unclassified			1b. RESTRICTIVE MARKINGS		
2a. SECURITY CLASSIFICATION AUTHORITY			3. DISTRIBUTION/AVAILABILITY OF REPORT Approved for public release; distribution is unlimited.		
2b. DECLASSIFICATION/DOWNGRADING SCHEDULE					
4. PERFORMING ORGANIZATION REPORT NUMBER(S)			5. MONITORING ORGANIZATION REPORT NUMBER(S)		
6a. NAME OF PERFORMING ORGANIZATION Naval Postgraduate School		6b. OFFICE SYMBOL (If applicable) AS		7a. NAME OF MONITORING ORGANIZATION Naval Postgraduate School	
6c. ADDRESS (City, State, and ZIP Code) Monterey, CA 93943-5000			7b. ADDRESS (City, State, and ZIP Code) Monterey, CA 93943-5000		
8a. NAME OF FUNDING/SPONSORING ORGANIZATION		8b. OFFICE SYMBOL (If applicable)		9. PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER	
8c. ADDRESS (City, State, and ZIP Code)		10. SOURCE OF FUNDING NUMBERS			
		Program Element No		Project No	Task No
					Work Unit Accession Number
11. TITLE (Include Security Classification) Potential Impact of the Elimination of the M Account on the Department of the Navy (Unclassified)					
12. PERSONAL AUTHOR(S) Fegurgur, Ben A. and Marinello, Anthony F.					
13a. TYPE OF REPORT Master's Thesis		13b. TIME COVERED From To		14. DATE OF REPORT (year, month, day) December 1991	
				15. PAGE COUNT 140	
16. SUPPLEMENTARY NOTATION The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.					
17. COSATI CODES			18. SUBJECT TERMS (continue on reverse if necessary and identify by block number)		
FIELD	GROUP	SUBGROUP	Appropriations, M Account, Merged Surplus Account, Expired Appropriations		
19. ABSTRACT (continue on reverse if necessary and identify by block number) This thesis addresses the impact of Public Law 101-510, which eliminated the M Account, on financial management within the Department of the Navy. The M Account was established for the payment of prior year obligations from appropriations which had lapsed. The M Account process provides the necessary flexibility to Navy contract administrators and financial managers to manage resources related to the closure of prior year contracts. Public Law 101-510 was enacted in 1990 based on congressional concern over Department of Defense management of the M Account. This study examines this law and the impact this legislation will have on future financial decision-making in the Department of the Navy. The assessment focuses specifically on the Procurement and Operations and Maintenance appropriations for the Navy.					
20. DISTRIBUTION/AVAILABILITY OF ABSTRACT <input checked="" type="checkbox"/> UNCLASSIFIED/UNLIMITED <input type="checkbox"/> SAME AS REPORT <input type="checkbox"/> DTIC USERS			21. ABSTRACT SECURITY CLASSIFICATION Unclassified		
22a. NAME OF RESPONSIBLE INDIVIDUAL Richard A. Harshman			22b. TELEPHONE (Include Area code) (408) 646-2205		22c. OFFICE SYMBOL Code AS/11a

Approved for public release; distribution is unlimited.

POTENTIAL IMPACT OF THE ELIMINATION OF THE M ACCOUNT
ON THE DEPARTMENT OF THE NAVY

by

Ben A. Fegurgur

Lieutenant Commander, Supply Corps, United States Navy
B.S., United States Naval Academy, 1979

and

Anthony F. Marinello

Lieutenant, Supply Corps, United States Naval Reserve
B.A., Old Dominion University, 1986

Submitted in partial fulfillment
of the requirements for the degree of

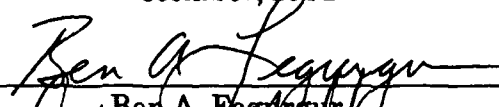
MASTER OF SCIENCE IN MANAGEMENT


from the

NAVAL POSTGRADUATE SCHOOL

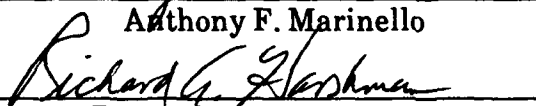
December, 1991

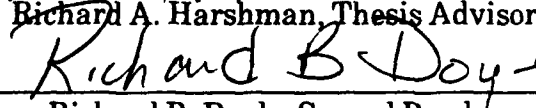
Authors:

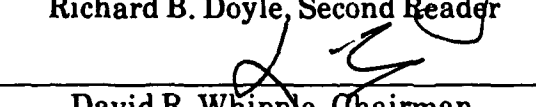

Ben A. Fegurgur


Anthony F. Marinello

Approved by:


Richard A. Harshman, Thesis Advisor


Richard B. Doyle, Second Reader


David R. Whipple, Chairman
Department of Administrative Sciences

ABSTRACT

This thesis addresses the impact of Public Law 101-510, which eliminated the M Account, on financial management within the Department of the Navy. The M Account was established for the payment of prior year obligations from appropriations which had lapsed. The M Account process provides the necessary flexibility to Navy contract administrators and financial managers to manage resources related to the closure of prior year contracts.

Public Law 101-510 was enacted in 1990 based on congressional concern over Department of Defense management of the M Account. This study examines this law and the impact this legislation will have on future financial decision-making in the Department of the Navy. The assessment focuses specifically on the Procurement and Operations & Maintenance appropriations for the Navy.

Accession For	
NTIS GRA&I	<input checked="checked" type="checkbox"/>
DTIC TAB	<input type="checkbox"/>
Unannounced	<input type="checkbox"/>
Justification	
By	
Distribution/	
Availability Codes	
Dist	Avail and/or Special
A-1	

TABLE OF CONTENTS

I.	INTRODUCTION	1
A.	BACKGROUND	1
B.	PURPOSE AND OBJECTIVE OF THE RESEARCH	3
C.	SCOPE, LIMITATIONS AND ASSUMPTIONS	3
D.	RESEARCH METHODOLOGY	4
E.	THESIS ORGANIZATION	5
II.	ESTABLISHMENT OF THE M-ACCOUNT	7
A.	INTRODUCTION	7
B.	APPROPRIATION LIFE CYCLE	7
	1. OBLIGATIONAL AVAILABILITY	7
	2. EXPENDITURE AVAILABILITY PERIOD	8
	3. LAPSED APPROPRIATION	9
C.	PRIOR TO THE M-ACCOUNT	10
D.	CREATION OF THE M-ACCOUNT	13
E.	CHAPTER SUMMARY	16
III.	CONGRESS CALLS FOR REFORMS	17
A.	INTRODUCTION	17
B.	CONGRESSIONAL CONCERNS	18
	1. CAUSES FOR THE M ACCOUNT AND MERGED SURPLUS ACCOUNT GROWTH	19

a.	GROWTH IN DOD BUDGET	21
b.	PROCUREMENT OF HIGHLY TECHNOLOGICAL SYSTEMS	21
c.	FAILURE TO PROPERLY VALIDATE OBLIGATIONS	23
2.	LACK OF CONGRESSIONAL CONTROL OVER THE M ACCOUNT	25
a.	UPWARD ADJUSTMENTS	25
b.	CAUSES OF UPWARD ADJUSTMENTS	27
3.	INADEQUATE FINANCIAL MANAGEMENT CONTROLS . .	28
C.	MAJOR REQUIREMENTS INSTITUTED BY P.L. 101-510 .	29
1.	CANCELLATION OF THE M AND MERGED SURPLUS ACCOUNTS	30
2.	CHARGING CLOSED APPROPRIATIONS TO CURRENT APPROPRIATIONS TO PAY OBLIGATIONS	32
a.	FISCAL YEAR IDENTITY	33
b.	USE OF CURRENT APPROPRIATIONS	33
3.	CONTRACT CHANGES	34
4.	ANNUAL REPORTING	35
5.	AUDIT OF OBLIGATED BALANCES OF THE DEPARTMENT OF DEFENSE	36
D.	CHAPTER SUMMARY	37
IV.	DON INTERPRETATION OF P.L. 101-510	39
A.	INTRODUCTION	39
B.	FINANCIAL MANAGEMENT ORGANIZATION	39

C.	DON GUIDANCE FOR ADMINISTRATION OF APPROPRIATIONS	
	AFTER THE PERIOD OF AVAILABILITY	42
1.	UPWARD ADJUSTMENTS FOR EXPIRED APPROPRIATIONS	
	42
a.	CONTRACT CHANGES	43
b.	PROGRAM, PROJECT, OR ACTIVITY	45
c.	OBLIGATIONAL ADJUSTMENTS	46
2.	UPWARD ADJUSTMENTS FOR CLOSED APPROPRIATIONS	46
3.	EXTENDED AVAILABILITY FOR SCN AND O&M,N	
	APPROPRIATIONS	48
a.	EXTENDED AVAILABILITY	48
b.	CONTRACT CHANGES	49
4.	OBLIGATION ADJUSTMENT RECORDKEEPING	50
5.	APPLICABILITY OF THE ANTI-DEFICIENCY ACT	51
6.	UNLIQUIDATED OBLIGATION REVIEW	52
D.	CHAPTER SUMMARY	53
V.	PROCUREMENT ACCOUNTS	54
A.	INTRODUCTION	54
B.	PROCUREMENT ACCOUNTS	54
C.	PROCUREMENT FUNDS FLOW	57
1.	BUDGET FORMULATION	57
2.	FUNDS FOR BUDGET EXECUTION	60
D.	CONTRACTING PROCESS	62
1.	CONTRACT ADMINISTRATION	63
2.	INACCURATE RECORDS	65

E. NAVY ACCOUNTING SYSTEM	66
VI. IMPACT ON PROCUREMENT ACCOUNTS	69
A. INTRODUCTION	69
B. USE OF CURRENT FUNDS	71
C. CONTRACT CHANGES	76
D. CONTRACT CLOSEOUT	80
E. EXTENDED AVAILABILITY OF SHIPBUILDING AND CONVERSION, NAVY	83
F. CHAPTER SUMMARY	85
VII. THE OPERATION AND MAINTENANCE ACCOUNT AND THE M ACCOUNT	86
A. INTRODUCTION	86
B. OPERATION AND MAINTENANCE, NAVY ACCOUNT	86
C. FLOW OF FUNDS	89
D. FINANCIAL MANAGEMENT REPORTING SYSTEM	91
1. DON INTEGRATED DISBURSING AND ACCOUNTING SYSTEM (IDA)	94
2. NAVY ACCOUNTING SYSTEM	98
VIII. IMPACT ON THE OPERATIONS ACCOUNT	101
A. INTRODUCTION	101
B. FORCES AFLOAT	101
C. SUB-CLAIMANT (TYPE COMMANDER)	106
D. MAJOR CLAIMANT	109

E. FIPC	112
IX. CONCLUSIONS	116
A. INTRODUCTION	116
B. SUMMARY	116
C. CONCLUSIONS AND RECOMMENDATIONS	121
D. AREA FOR FURTHER RESEARCH	123
LIST OF REFERENCES	124
INITIAL DISTRIBUTION LIST	127

LIST OF ABBREVIATIONS AND ACRONYMS

AAA	Authorization Accounting Activity
ACO	Administrative Contracting Officer
ADP	Automatic Data Processing
AO	Administering Office
APN	Aircraft Procurement, Navy
ASN	Assistant Secretary of the Navy
BA	Budget Authority
CAM	Claimant Accounting Module
CFO	Completion and Fitting Out
CMC	Commandant of Marine Corps
CD-ROM	Compact Disk Read Only Memory
CERPS	Centralized Expenditure/Reimbursement Processing System
CIM	Corporate Information System
CINC	Commander in Chief
CINCPACFLT	Commander in Chief, U.S. Pacific Fleet
COMNAVSURFPAC	Commander Naval Surface Forces, Pacific
DCAA	Defense Contract Audit Agency
DCAS	Defense Contract Administration Services
DCMAO	Defense Contract Management Administrative Office
DCMC	Defense Contract Management Command

DCMD	Defense Contract Management District
DFAS	Defense Finance and Accounting System
DLA	Defense Logistics Agency
DMR	Defense Management Review
DOD	Department of Defense
DON	Department of the Navy
DPRO	Defense Plant Representative Office
ECP	Engineering Change Proposal
EOB	Expense Operating Budget
FAA	Fund Administering Activity
FAADCPAC	Fleet Accounting and Disbursing Center, Pacific
FAADCLANT	Fleet Accounting and Disbursing Center, Atlantic
FAR	Federal Acquisition Regulation
FIPC	Financial Information Processing Center
FMIP	Financial Management Improvement Plan
FRAM	Fleet Resource Accounting Module
FRS	Financial Resource System
FYDP	Five Year Defense Plan
GAO	General Accounting Office
HAC	House Appropriation Committee
HCGO	House Committee on Government Affairs
IDA	Integrated Disbursing and Accounting
IDAFIPS	Integrated Disbursing and Accounting Financial Information Processing System

IDAFMS	Integrated Disbursing and Accounting Financial Management System
IG	Inspector General
MILSCAP	Military Standard Contract Administration Procedures
MOA	Memorandum of Agreement
MPN	Military Pay, Navy
MYP	Multi-year Procurement
NAVAIR	Naval Air Systems Command
NAVCOMPT	Comptroller of the Navy
NAVSEA	Naval Sea Systems Command
NGAS	Navy General Accounting System
NHRS	Navy Headquarters Reporting System
NRFC	Navy Regional Finance Center
NSC	Naval Supply Center
O&M,N	Operation and Maintenance, Navy
O&M,NR	Operation and Maintenance, Naval Reserve
OB	Operating Budget
OMB	Office of Management and Budget
OPFORCES	Operational Forces
OPTAR	Operating Target
OSD	Office of Secretary of Defense
OWLD	Obligation and Work Limiting Date
PARM	Participating Manager
PARS	Procurement Accounting and Reporting System
PCC	Practical Comptrollership Course

PCO	Procurement Contracting Officer
PEO	Program Executive Officer
PM	Program Manager
POA&M	Plan of Action and Milestone
PPA	Program, Project or Activity
PPBS	Planning, Programming and Budgeting System
PR	Procurement Request
PRISMM	Pattern Recognition and Imaging System for Material Management
RDT&E	Research, Development, Test and Evaluation
REA	Request for Equitable Adjustment
RFM	Requiring Financial Manager
RO	Responsible Office
SCGA	Senate Committee on Government Affairs
SCN	Shipbuilding and Conversion, Navy
SECNAV	Secretary of the Navy
SSPO	Strategic Systems Project Office
SUPSHIPS	Supervisor of Shipbuilding
STARS	Standard Accounting and Reporting System
TCO	Terminating Contracting Officer
TOA	Total Obligational Authority
ULO	Unliquidated Obligations

I. INTRODUCTION

A. BACKGROUND

The research area consists of an analysis of a financial management mechanism called the M account. It will examine Congress' decision to eliminate the M account and how this will impact future financial decision-making in the Navy.

A number of factors influence the congressional budget process. There is no greater threat to Congress than to dilute the authority it derives from the Constitution to approve government spending. The M account posed the very kind of threat that magnified the battle lines that have been fought between legislative and executive powers for the past two centuries.

Prior to 1990, all obligated appropriated budget authority for the Navy remained available to pay valid expenditures long after the appropriation expired. These funds were moved into a successor M account, which became a large sum of unexpended balances not identified by fiscal year. When the Navy incurred valid expenditures or certain upward adjustments to old contracts, they were paid from the M account.

To most of Congress, this process of keeping track of expenditures and unexpended balances was an unknown accounting operation. When the Air Force informed the Congress in 1989

that it planned to use almost \$1 billion from the M account to correct problems in the B1-B bomber's avionics system, many members of Congress became alarmed. Congress could not accept the possibility that the Air Force was bypassing Congress in obtaining funds. As Rep. Ireland (D-FL.) testified before the U.S. Senate,

Evidently, the Air Force must no longer rely on Congress to appropriate funds for projects that it wishes to pursue. If the Congress says no to a given project, then the Air Force can simply use expired "M" account authority to keep the project going. (SCGA Report No. 101-1085, 1990, p. 14)

In 1990, Congress enacted Public Law 101-510 to address this problem. Basically, the law states that the M account will be eliminated as of September 30, 1993. Effective immediately, no additional unobligated balances will be transferred to the M account. Instead, separate appropriations (specific expired accounts) will be maintained for five years for the purposes of adjusting obligations and making disbursements beginning with fiscal year 1989. Any obligated balances that are canceled after the five-year period which subsequently require payment may be paid from current year appropriations, subject to limitations.

Department of Defense (DOD) agencies are required to set aside one percent of current annual appropriations for closed prior-year accounts which have outstanding liquidated obligations. Thus, payment of the prior year unexpended balances are restricted to one percent of the current

appropriations. In those instances where this one percent is insufficient, current programs must be reduced or supplemental funding must be approved.

Many questions remain concerning the repercussions of this legislation. What is the impact of this law upon the budgetary process with respect to Department of the Navy (DON) procurement and operations accounts? Who is going to fund costs incurred to implement this legislation and how will it affect the operational units from the major claimant to the individual units on station?

B. PURPOSE AND OBJECTIVE OF THE RESEARCH

This thesis will examine the planning, documentation, and methods currently being employed in the implementation of new guidelines established by P.L. 101-510. The intent is to take an objective view of the activities currently under way and those planned in the implementation process. A question to be addressed throughout the research is how will both present and future funds management be affected by the new guidelines. Answers to this question can only be realized through analysis of the numerous factors associated with the terms of P.L. 101-510.

C. SCOPE, LIMITATIONS AND ASSUMPTIONS

The areas of study will focus on identifying the impact of the new legislation on certain DON activities in implementing

the changes required. The thesis will essentially provide an impact assessment of a policy change enacted by Congress. The assessment will concentrate on appropriations in both the procurement and operations accounts. Specifically, the analysis will concentrate on requirements for the activities in the Pacific Fleet and the Naval Systems Command.

D. RESEARCH METHODOLOGY

The research phase of this study began with a definition of the problem to be examined and the scope of the research itself. The research was accomplished primarily through a literature search and interviews.

A search of the Defense Logistics Studies Information Exchange data base revealed very little published material concerning current and past issues involving the M account. Consequently, research materials were primarily limited to publications, directives, manuals, and briefing materials provided from sources associated with the M account.

Materials covering the M account were obtained from DOD sources and congressional hearings and reviewed thoroughly to gather background information. Extensive personal interviews and telephone interviews were conducted with personnel involved in the financial management of DOD funds. Included in these interviews were members of the Office of the Secretary of Defense, Office of the Navy Comptroller, major

claimants, Naval Audit Service, type commander, Financial Information Processing Centers, and operational units.

To assist in understanding the impact of the elimination of the M account on the procurement and operations accounts, research visits were conducted with the Office of the Comptroller of the Navy, Naval Air Systems Command, Naval Sea Systems Command, Naval Audit Service, Commander Surface Forces, U.S. Pacific Fleet and Fleet Accounting and Disbursing Center, Pacific Fleet.

E. THESIS ORGANIZATION

Presentation of this research effort is organized into nine chapters. Chapter I briefly introduced the research topic and the importance of studying this area. The objectives and methodologies were also delineated.

Chapter II provides background information on the establishment of the M account. In doing so, details on the life cycle of appropriations are discussed in order to give the reader a clear concept of the relationship between appropriations and the M account. Also, the prevailing scenario before the inception of the M account and the factors leading to the establishment of the M account will be addressed.

In Chapter III, congressional call for reform, the factors leading to the enactment of P.L. 101-510, and the terms of P.L. 101-510 are discussed.

Chapter IV discusses the key players in the Navy's financial management organization and synopsizes their interpretation of OSD guidance through NAVCOMPT Instruction 7040.37B.

Chapter V provides a description of the Navy investment accounts, specifically the Procurement accounts and their relationship with the activities involved in the budget execution of these accounts. It will provide background information on the relationships between the system commands and the those responsible for the financial and contract management. Chapter VI will explore the issues impacting managers because of P.L. 101-510 and how financial and acquisition policies may change in the future.

Chapter VII provides a description of the operation and maintenance account, an overview of the Navy accounting system (operational forces) and the operation and maintenance account link to the M account. Chapter VIII identifies problems and issues influencing the operational accounts set by the new guidelines.

Significant findings of the study are summarized in Chapter IX. Conclusions and recommendations are drawn from the interpretation of data identified in free form commentary and interviews. Additionally, concluding remarks on potential areas for further research are discussed.

II. ESTABLISHMENT OF THE M-ACCOUNT

A. INTRODUCTION

This chapter provides background information on the establishment of the M account. Details on the life cycle of appropriations are discussed in order to give the reader a clear concept of the relationship between appropriations and the M account. Also, the prevailing scenario before the inception of the M account and the factors leading to the establishment of the M account will be addressed.

B. APPROPRIATION LIFE CYCLE

There are three primary limits of an appropriation: purpose, dollar limits and time limitation. This section will concentrate on the period when an appropriation is available for obligation, adjustment and disbursement.

1. OBLIGATIONAL AVAILABILITY

Funding is approved by Congress in the form of appropriations. By definition, an appropriation is a statute that provides budget authority for DOD to incur obligations and to make payments out of the U.S. Treasury for specified purposes. As shown on Figure 2.1, appropriations have a specific obligational availability period or duration which can be grouped as annual, multiple year or continuing/no year. For example, procurement appropriations (aircraft procurement,

DON APPROPRIATIONS			
EXPENSE	OPERATIONS & MAINTENANCE	O&M,N O&M,NR	O&M,MC O&M,MCR
	MILITARY PAY	MPN RPN	MOMC RPMC
	RESEARCH	RDT&E	
INVESTMENT	PROCUREMENT	APN WPN OPN PMC	
	CONSTRUCTION	MCN MCNR	

Figure 2.1 OBLIGATIONAL AVAILABILITY ON DON APPROPRIATIONS

weapons procurement and other procurement) are generally available for three years while operation and maintenance appropriations are available for one year. During their specified period of availability, appropriations are considered to be current and DOD activities can award contracts or obligate funds and make payments with this budget authority.

2. EXPENDITURE AVAILABILITY PERIOD

Upon completion of the obligational availability period, the expenditure availability period continues until

all unliquidated obligations are resolved. During this phase, an appropriation is considered expired and may not be used for incurring new obligations. However, this appropriation may be used in certain circumstances to pay bills for items or services for which obligations have already been incurred, even if the amount is more than the initial amount obligated. Prior to 1956, payment of bills using expired budget authority could be made only after the agency involved and GAO examined the bills and certified that payment was appropriate.

Unobligated funds still remaining at the end of an obligational availability period may be used to cover price increases (within scope¹) and unprecedented disbursements for financial transactions that were initiated prior to the end of the obligational availability period.

3. LAPSED APPROPRIATION

In 1956, P.L. 84-798 streamlined the payment process by transferring the responsibility and authority for these review and payment procedures from GAO to the federal agencies. Under this legislation, a lapsed appropriation became an appropriation for which the undisbursed balance would no longer be available for payment, as the two-year expenditure availability period has concluded.

¹Within the scope change relates to the increase in the government's liability in a contract following changed circumstances or the occurrence of contingencies that were unknown or impossible to quantify when the contract was executed.

Public Law 84-798 also established the M account and the Merged Surplus authority as repositories for unspent budget authority. The M account accumulates balances of obligated but unpaid budget authority and the Merged Surplus account accumulates balances of budget authority that has not been obligated. While the budget authority in the M account and the Merged Surplus authority maintain their general purpose identity, they do not maintain the fiscal year identity of the original appropriation.

Under certain conditions funds may be restored to the M accounts from the Merged Surplus Fund account when existing obligation amounts were underestimated and unrecorded. However, the M account balances are only available for the liquidation of existing claims against the government and are not available to fund new obligations. Similarly, the balance in the Merged Surplus Fund may only be used to adjust recorded obligations, not for new or expanded programs.

Figure 2.2 summarizes the appropriation life cycle from 1956 to 1990.

C. PRIOR TO THE M-ACCOUNT

Prior to 1949, appropriations lapsed into two fiscal years after the end of their period of availability and the unexpended balances of those appropriations were covered into the surplus fund of the Treasury. Subsequent claims against these appropriations were subject to certification and

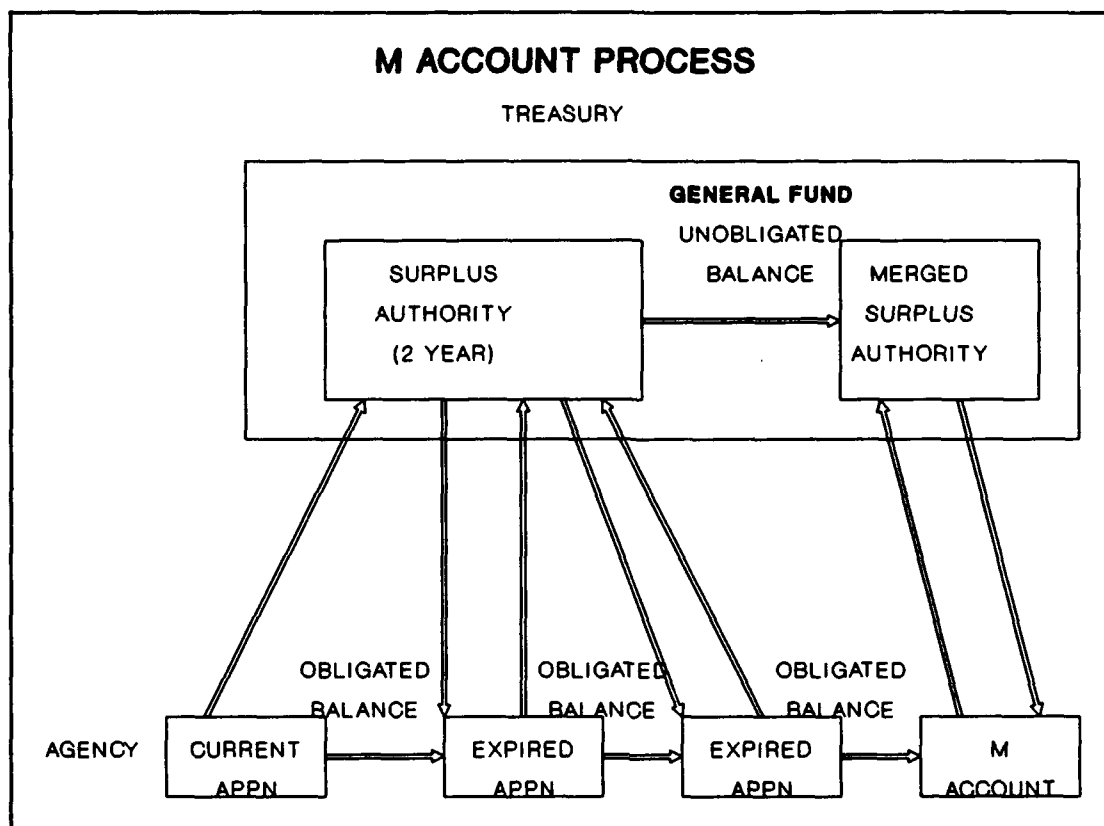


Figure 2.2 M ACCOUNT PROCESS BEFORE P.L. 101-510

settlement by GAO, but they required the enactment of reappropriation legislation in order to be paid. The administrative process that was involved in making these payments was needlessly burdensome. Consequently, Congress enacted legislation in 1949 to permit payment of certified claims against lapsed appropriations, without the need for specific appropriations or reappropriations.

Under the 1949 Act, GAO was responsible for certifying and paying all obligations for all government agencies resulting from prior year activities. Unliquidated obligated balances which remained after two years were transferred to an account

in the Department of the Treasury called the "Payment of Certified Claims" account. Claims against agencies which resulted from prior year activities submitted after the two year period were required to be examined by the agency concerned and certified by GAO before payments could be disbursed from the "Payment of Certified Claims" account. Funds in the account not required for payment of claims were to be directed into the surplus fund of the Treasury.

This requires maintenance in the General Accounting Office of detailed ledger accounts for the lapsed appropriations and the substantial utilization of the services of trained claims adjudicators and supporting personnel in processing such payments. In addition, the payment are recorded as expenditures as the Department of the Treasury rather than as expenditures of the agencies benefiting therefrom. (SCGA Report No. 84-2172, 1956, p.39)

The single government wide approach enacted in 1949, however, proved to be unsatisfactory. The Comptroller General was maintaining some fifty thousand accounts and annually had to certify thirty to forty thousand claims that raised no questions of law or fact, duplicating initial agency approvals.

The agencies have the same amount of work in connection with this type of claim. Processing of these through the Claims Division constitutes a duplication of effort that can easily be avoided by extending the statutory period for reimbursement and by a study of a executive department aimed at speeding up the payment process. (SCGA Report No. 84-2172, 1956, p.39)

To eliminate this duplication and to facilitate the restructuring of GAO, the 1956 Act replaced the single government wide system with a system of merged accounts for

each general appropriation purpose maintained by the responsible agencies.

D. CREATION OF THE M-ACCOUNT

Public Law 84-798 was the result of a combined initiative by GAO, the Bureau of the Budget (the predecessor of the Office of Management and Budget), and the Department of the Treasury. It was designed to simplify and streamline the federal government's system for paying obligations. Moreover, this change in payment procedures allowed for the simultaneously restructuring of GAO.

In 1956, Congress was exploring the concept of restructuring GAO. Congress would transfer payment tasks to the federal agencies, thereby allowing GAO to become a "watchdog" organization responsible for auditing the federal agencies.

Substantial economies would be obtained if the agencies were authorized to make direct settlement of claims without their prior submission to the General Accounting Office, except in those cases involving questions involving law or fact. If this were done, unexpended balances of closed appropriations which are normally transferred to the "payment of certified claims" account maintained at the Treasury Department should be retained in the agencies. Agency procedures in settling claims would, of course, be subject to review and audit by the General Accounting Office. (HCGO Report No. 84-192, 1955, p.43)

GAO testified in Congress that the current accounting system was repetitive, time-consuming, and expensive. GAO successfully urged Congress "to streamline a cumbersome

process for certifying separate payments from appropriation account balances" by using the M and Merged Surplus accounts as a more efficient and cost effective method (GAO Report No. T-AFMD-90-26, 1990, p.2).

Congress also expressed the belief that the new accounting system as proposed by Public Law 84-798 would ensure the more timely payment of claims since it would remove GAO from the process of reviewing, certifying, and paying obligations resulting from prior year activities where there was no doubtful question of law or fact.

During 1954, 38,000 of the claims received by the General Accounting Office related to lapsed appropriations. Approximately 28,000 of them did not involve any doubtful or complex matter. It is apparent that under existing procedure the General Accounting Office is engaged in examining and settling as "claims" many requests for payment which are routine and involve no questions of law or fact. (HCGO Report No. 84-192, 1955, p.43)

As noted earlier, the responsibility for making these payments would be transferred to the actual agency incurring the claim. Previously, payments made from the "Payment of Certified Claims" account were reported as expenditures of the Department of the Treasury instead of the agency receiving the benefits. In eliminating a workload of 35,000 itemized ledger accounts for the lapsed appropriations, GAO forecasted a savings of approximately \$600,000 annually (GAO Report No. NSIAD-91-156, 1991, p.36).

Simultaneously, DOD expressed a concern for the handling of unforeseen upward adjustments. DOD felt that due to

variations in quantity and escalation clauses, incentive/cost reimbursement type contracts and price adjustments, there were large adjustments of unliquidated obligations at the end of each fiscal year. By allowing a provision in Public Law 84-798 authorizing restorations to the M account from the Merged Surplus authority to cover upward adjustments from contract costs, agencies would have the flexibility to expedite payments more quickly. This would allow the agency to utilize funds already appropriated to it (but not obligated) and eliminate the necessity of asking Congress for a reappropriation of funds. Therefore, DOD also supported the enactment of Public Law 84-798 with the inclusion of this additional provision. GAO, though, believed that this provision would rarely if ever be invoked and did not expect the balances in these accounts to fluctuate substantially.

In 1956, Public Law 84-798 transferred the responsibility and authority for maintaining non-current appropriation accounts from GAO to the agencies creating the obligations. From the implementation of this law until 1989, this process of keeping track of expenditures and unexpended balances was an unknown accounting operation. Moreover, even with the tremendous growth in DOD and complexities in the acquisition process, there have been few changes to P.L. 84-798.

E. CHAPTER SUMMARY

This chapter provided the prevailing scenario prior to the M account and the factors leading to the establishment of the M account. However, when the Air Force informed the Congress in 1989 that it planned to use almost \$1 billion from the M account to correct problems in the B1-B bomber's avionics system, many members of Congress became shocked and outraged. They believed that this federal "slush fund" was ripe for fraud and abuse. As echoed by Senator David H. Pryor, D-AR:

It is in my opinion, an invitation to corruption ... an invitation to circumvent the budget process...and believe we have to act very quickly to remedy what I called an egregious situation. (Sia, 1990, p.1).

This introduced the conditions leading to congressional calls for reform of the M account.

III. CONGRESS CALLS FOR REFORMS

A. INTRODUCTION

The National Defense Authorization Act for Fiscal Year 1991, Public Law 101-510, dated November 5, 1990, introduced a major change in the management of expired appropriations. It phased out existing M accounts, eliminated the Merged Surplus authority, and made expired appropriations available to agencies for a finite period. Since 1956, the legislation creating the M and Merged Surplus accounts has ensured the flexibility of agencies to make disbursements after the primary source appropriation expires.

As public concern began to focus on the budget deficit, the nature of government outlays brought the M and Merged Surplus accounts to the attention of the U.S. Congress. Specifically, the Air Force proposal to use \$1 billion from the M account for the B1-B bomber became the catalyst for Congressional attention on expired appropriations.

The source of funds for the modifications to the B1-B defensive avionics system was disclosed in hearings before congressional authorization and appropriation committees. GAO was subsequently asked to evaluate whether the use of the M account for this purpose complied with applicable laws and regulations. The GAO analysis determined that the funds were

within the scope of the original contract and that the Air Force was able to use balances in the M account to fund the contract modifications. (GAO Report No. NSIAD-89-209)

Yet, Congress grew concerned that the military services' access to and use of large amounts of expired budget authority presented a danger to congressional oversight of the budgetary process. Furthermore, the growth of the M account alarmed the Congress as to the questionable management of the expired appropriations. Senator Glenn (D-OH) noted that,

... their (M account) general availability to the agencies must create an environment conducive to sloppy or wasteful program management practices. (SCGA Report No. 101-1085, 1990, p.3)

Chapter III will focus on these congressional concerns regarding the M and Merged Surplus accounts and the reasoning behind the major requirements instituted by P.L. 101-510.

B. CONGRESSIONAL CONCERNS

The design of the M and Merged Surplus accounts was an enigma for some members of Congress. For example, when discussing the use of the M account for the B1-B bomber, Rep. John Murtha (D-PA), Chairman of the House Defense Appropriation Subcommittee, expressed his trepidation:

So when you start getting into something as difficult to understand and as technically complicated as the M accounts it makes us very nervous, so we would expect the Air Force to listen to what we say in the statement of the managers, and pay attention or we will have to put it into law. So that is what it amounts to. (HAC subcommittee Hearings, 1990, p.125)

Congress did not fully understand the operation of the M account and was disturbed that a misuse of the Merged Surplus account by DOD could significantly affect the budget deficit by incurring outlays. Congress identified three major concerns that could lead to the misapplication of the M and Merged Surplus accounts: 1) the size of these accounts, 2) the lack of Congressional oversight in the use of the accounts, and 3) the inadequate financial management controls in the management of the M and Merged Surplus accounts.

1. CAUSES FOR THE M ACCOUNT AND MERGED SURPLUS ACCOUNT GROWTH

Since 1980, the M and Merged Surplus accounts have accumulated sizeable balances. Table 3.1 illustrates the growth in the DOD M account and Merged Surplus authority balances from fiscal year 1980 to fiscal year 1990 concurring with the growth of DOD budget authority (BA)².

Figures 3.1 and 3.2 graphically display the rapid growth of these balances in the period from 1980-1990.

² Budget authority is the authority to enter into obligations for payment (outlays) of Government funds.

TABLE 3.1

\$ in billions (current year)			
Fiscal year	M accounts	Merged Surplus	DOD (BA)
1980	2.7	15.2	142.6
1981	3.4	15.3	178.4
1982	3.3	16.3	213.8
1983	4.2	18.4	239.5
1984	5.0	18.3	258.2
1985	6.7	19.8	286.8
1986	9.6	21.3	281.4
1987	12.4	22.8	279.5
1988	15.0	24.4	283.8
1989	18.5	25.4	290.8
1990	18.8	27.1	293.0

(Source: GAO NSIAD-91-156)

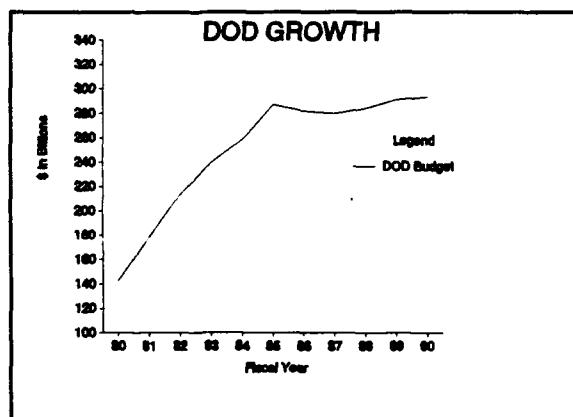


Figure 3.1

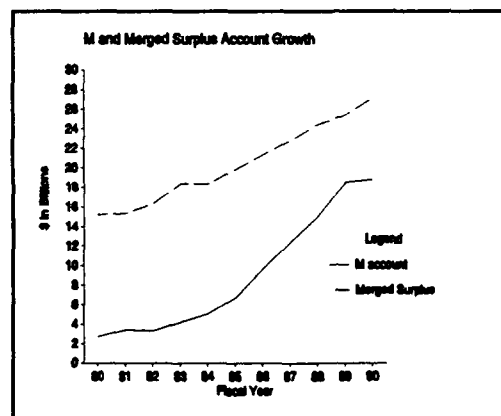


Figure 3.2

Obviously, much of the increase in these accounts occurred during the 1980's, a decade in which DOD budget authority was rapidly increasing. However, what are the causes of this substantial growth and apparent excesses ? The answers can be analyzed in the following areas.

a. GROWTH IN DOD BUDGET

The surge in the M account balance in the 1980's did not merely manifest itself from inefficient actions. During this same decade, the DOD budget was undergoing substantial growth, which provided the catalyst for the M account growth. The DOD Comptroller, Sean O'Keefe testified to this effect before the Committee on Governmental Affairs:

It is important though, I think, to explore the reasons why the accounts have grown so dramatically in the past 10 years, specifically. In 1977, for example, the size of the merged surplus and M combined was about \$16 billion. Today, it is over \$50 billion for the Department of Defense. Concurrently, though, the budget grew from \$108 billion in 1977 to \$290 billion in 1989. So there has been almost a proportionate increase in the size of the merged surplus and M accounts consistent with the size of the budget growth that has occurred over this same period of time. (SCGA, Report No. 101-1085, 1990, p.40)

Although the DOD budget did not cause inefficient performance, it provided the impetus for inefficient actions in the military services to multiply.

b. PROCUREMENT OF HIGHLY TECHNOLOGICAL SYSTEMS

Operation Desert Storm effectively exhibited the proficiency of highly technical weapon systems in combating the enemy with a minimal loss of allied personnel. Many

reasons can be credited for the military success of Operation Desert Storm; yet, the conflict was a display of advanced military weaponry. One of the objectives of the early years in DOD growth in the 1980's was to procure more technical and most assuredly more expensive systems. Major weapon systems and their associated platforms, whether land, sea or space oriented, are complicated and expensive. Due to the increased sophistication, extensive use of computers, long building periods and limited number of producers, it clearly is taking more time to build today's weapon system. This fact is evident in the trend for unliquidated obligations.

Highly technical programs required longer periods of time to complete the entire procurement cycle. The intricate and complicated standards required for producing these systems brought about a level of uncertainty in cost estimation that had never been encountered. A more expensive and longer procurement meant that larger amounts of budget authority remain obligated for longer periods of time before being disbursed. Consequently, larger amounts of budget authority have time to expire and lapse into the M account. The difficulty in maintaining program stability encouraged the growth in funding upward adjustments of prior obligation for cost overruns and contingent liabilities. (McNichols, 1983)

C. FAILURE TO PROPERLY VALIDATE OBLIGATIONS

We must not forget the element of human failure in responding to the increased handling of funds. We can see that the growth of the M account can be an indication of inefficient practices and insufficient accounting systems. In the period 1980-1990, a substantial increase in the flow of funds saturated every level of the services. Also, the level of operations for financial and accounting departments DOD wide was increased. Nevertheless, the existing accounting systems could not handle the quantity of information that was required for processing and tracking obligations. As pointed out by GAO,

While the law, since 1950, has required agencies to maintain adequate accounting systems, there is a recognition today that most of the government's accounting systems are outdated, inefficient, and ineffective, and that improvements in financial management are urgently needed. (GAO Report No. AFMD-88-63BR, 1988, p.13)

Yet, even today, information systems in the services are not standardized. Moreover, fund administrators at most commands continue to improperly validate their outstanding and unliquidated obligations. As a result, a significant portion of outstanding and unliquidated obligations that lapse into the M account will never be liquidated because of unrecorded obligations that were liquidated under other accounting codes.

A goal of defense accounting is to ensure that actual obligations ultimately match actual expenditures and,

thus, prevent the exceeding of the limitations imposed by Congress. Failure to post an obligation or an erroneous data entry may result in payments that cannot be matched to existing obligations. These are called "unmatched disbursements." In order to be an effective financial manager, outstanding obligations should be validated for these purposes:

- 1) to identify potential cancellation credit (and reobligate if not expired)
- 2) to uncover double charges
- 3) to expedite expenditure processing thus identifying potential price changes
- 4) to prevent obligations from lapsing into the M account

Finally, one needs to understand the incentives of governmental accounting at the lower levels of the services. The primary factor in the performance of a fund administrator is budget execution. How well did the fund administrator handle current year funds? The M account deals with problems at least three to eight years away from current realities. Therefore, the M account is a low priority item. There is no incentive for the fund administrator to work hard on past obligations. Derek Vander Schaaf, Deputy Inspector General, DOD, testified that "the Military Departments placed financial management priority on current accounts and gave far less emphasis to tasks such as validating unliquidated obligations in the M accounts" (SCGA Report No. 101-1085, 1990, p.85). Managers gain greater rewards and greater flexibility when

placing more emphasis on managing current budget authority than expired and lapsed budget authority.

2. LACK OF CONGRESSIONAL CONTROL OVER THE M ACCOUNT

According to Congress, the budgetary process could be circumvented by DOD's manipulation of funds from the M and Merged Surplus accounts. Billions of defense dollars were legally available for expenditure without Congressional approval. As Senator Glenn (D-OH) cautions:

... Congress has inadequate control over the use of these (M account) funds. Specifically, an agency like DOD can issue a change to an existing contract that increases the cost of a program above what Congress originally authorized and pay for it out of these merged accounts, all without coming back to Congress for approval. (SCGA Report No. 101-1085, 1990, p.2)

Congress was specifically concerned with the use of the Merged Surplus account to hide cost overruns. With this capability, DOD could mask the mismanagement of their major weapon programs without giving Congress the same degree of advance notice as in the reprogramming process.³

a. UPWARD ADJUSTMENTS

One of the reasons Congress is concerned about the large balances in the M and merged surplus accounts is that expired and lapsed budget authority is routinely used to fund

³Reprogramming is the use of funds in an original appropriation account for purposes other than those approved by Congress. It is a system to provide flexibility to DOD for addressing the changes that occur during execution of the budget. It involves notification to the Congress and in significant cases prior approval of the Congress before implementation.

upward adjustments. By using unobligated expired and lapsed authority out of the Merged Surplus account, the services would not have the same amount of Congressional oversight as reprogramming. Senator Charles Grassley (Iowa) concluded that "... using these accounts to pay for cost-overruns is a way to avoid rigid controls over the management of a weapon system and to avoid visibility into cost growth" (SCGA Report No. 101-1085, 1990, p.52).

Analysis was made by GAO relating to 708 requests for upward adjustments by the Navy and Air Force to determine the annual number of requests, the dollar amounts of the requests, and the reason for an upward adjustment during the period 1985 through 1989. Table 3.2 displays the number and the aggregate dollar value of upward adjustments by the Air Force and the Navy for each year during this period.

According to their analysis, the military services' use of expired and lapsed budget authority to fund upward adjustments of prior obligations increased with the increase of M and Merged Surplus account balances during the 1980's.

Table 3.2 AIR FORCE AND NAVY REQUESTS FOR UPWARD ADJUSTMENTS

\$ in millions					
	Fiscal Year				
	1985	1986	1987	1988	1989
Adjustments	72	58	150	164	174
Amount	\$56.9	\$59.0	\$207.7	\$411.1	\$559.9

(Source: GAO NSIAD-91-156)

b. CAUSES OF UPWARD ADJUSTMENTS

Analysis by GAO indicated that the primary reasons military services request expired and lapsed budget authority include the need to pay contract cost overruns, settlements of

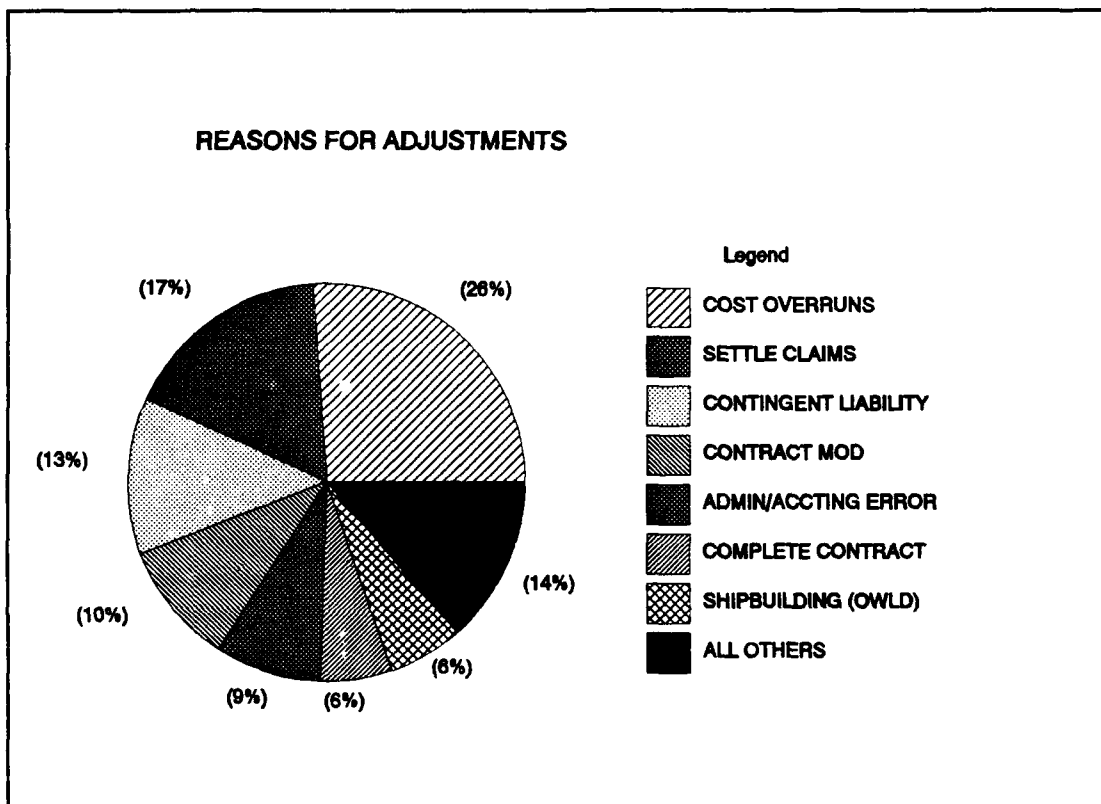


Figure 5.3 REASONS FOR UPWARD ADJUSTMENTS
(Source: GAO NSIAD-91-156)

claims by contractors, contingent liabilities⁴, and increases caused by contract changes requiring additional work by the contractor.

⁴A contingent liability is an existing condition, situation, or set of circumstances, involving considerable uncertainty, which may, through one or more related future events, result in the loss or impairment of an asset and/or the incurrence of a liability.

Figure 3.3 provides the reasons cited by the services broken down as a percentage of requests.

3. INADEQUATE FINANCIAL MANAGEMENT CONTROLS

Congress perceived that a potential for fraud could occur due to the weak internal controls in the management of the M and Merged Surplus accounts. As the M and Merged Surplus accounts grew in the period from 1980-1990, they became behemoths that could not be audited. Senator Roth verbalized this concern:

Given the lack of an audit trail at some agencies, the disposition of M accounts occurs without appropriate checks and balances. These accounts can be as flexible as the agency wants-it's a program manager's dream, a financial manager's headache, and a taxpayer's nightmare. (SCGA Report No. 101-1085, 1990, p.8)

Another reason for the large balances in the services' M and Merged Surplus accounts has been that DOD and the services have not audited these accounts to ensure that balances represent valid obligations. The DOD accounting procedures require that unliquidated obligations for all appropriations, including the M account, are required to be validated on an annual basis. In March 1990, the OSD Inspector General reported on a review of DOD's M accounts which found programmatic problems in several areas, including reconciliation and validation of obligations. It also reported that the unliquidated balances in the M account were inaccurate. (GAO Report No. NSIAD-91-156, 1991, p.16)

However, the accounts lapsing into the M account lost their fiscal year identity. Therefore, an audit of the M account was very difficult and presented a clear danger to the accountability of the appropriation process. Representative Ireland (D-FL) observed that the lack of fiscal year identity fostered negligent accounting practices.

When government money is stripped of its fiscal year and line item identity, as it is in the surplus accounts, the audit trail disappears. Records are destroyed. Linkage between appropriation and contracts is broken down. When that happens, anything goes.

So how should we proceed in the absence of accurate and complete information on the "M" accounts? If the Department of Defense refuses to audit the "M" accounts, we have no choice but to abolish them. That is the driving force between the bills that we have in the House. (SCGA Report No. 101-1085, 1990, p. 16)

C. MAJOR REQUIREMENTS INSTITUTED BY P.L. 101-510

Several bills (H.R. 5121, S.2699, and S.2951) were introduced in both houses of the Congress aimed at modifying the availability and control over expired appropriations. The Senate provided two plans to limit the availability of expired appropriations. The bills produced by Senator Glenn (D-OH) and Senators Roth (R-DE) and Grassley (R-IA) contained the primary concepts behind Public Law 101-510.

The P.L. 101-510 directed significant changes in funding, accounting and reporting procedures involving unpaid obligations and obligation adjustments for expired and lapsed accounts. The new legislation changed the period of time and

the procedures for the liquidation and adjustments of obligations after an appropriation's period of availability. The legislation also provided new rules governing the treatment of obligated and unobligated balances of appropriations following their period of availability; canceled unpaid obligations and unobligated balances after a five year period; provided for an audit and yearly reporting; and contained limitations and approval requirements for upward obligation adjustments. This section will cite these major provisions of the law and provide the reasoning behind them.

1. CANCELLATION OF THE M AND MERGED SURPLUS ACCOUNTS

The conclusions drawn from all participants during congressional testimony conveyed an apparent message: severe restriction of the M and Merged Surplus Accounts was needed. Members from the legislative body as well as executive representatives agreed that the Merged Surplus would have to be dissolved. Representative Ireland (D-FL) conveyed this viewpoint towards the Merged Surplus account:

There is a consensus for eliminating merged surplus accounts and I think we should take advantage of it. The Department of Defense Comptroller, Sean O'Keefe's House testimony on June 6th is an example of the movement in this area.

He agreed that the \$31.8 billion merged surplus account was far in excess of what is needed. In quoting his testimony he said, " We don't have any demand for it. We fully support wiping out the balances in those merged surplus accounts." (SCGA Report No. 101-1085, 1990, p.15)

Immediate elimination of the Merged Surplus account would leave three types of appropriations on the books: unexpired funds, expired funds not yet transferred to M Accounts (including balances restored from surplus accounts), and M account funds. (Knight, 1991, p.7)

However, members of the executive branch wanted certain conditions attached to the elimination of the M account. Sean O'Keefe laid out a major stipulation. He observed that "in view of the slow spend out pace in programs like shipbuilding, it would be advisable to retain balances for obligation adjustments for at least five years after an appropriation expires..." (SCGA Report No. 101-1085, 1990, p.91)

Evidently, parties concerned concluded that the five year window would give agencies a reasonable time period to pay legitimate bills. The congressional testimony of the deputy director of the Office of Management and Budget (OMB), Mr. Diefenderfer, maintained this view:

While spend out patterns vary by account in the nature of program, agency staff suggests that most accounts will have completed 99 percent of outlays in 5 years. This same period appears to be a reasonable time frame to cover legitimate obligation adjustments, particularly in most administrative and grant accounts. (SCGA Report No. 101-1085, 1990, p.30)

The new five year period would be similar to the two year period under the old system after appropriations expired and before balances were transferred to M accounts or Merged Surplus accounts. (Knight, 1991, p.9)

These aggregate views resulted in the following provision in section 1552(a) of P.L. 101-510:

On September 30th of the 5th fiscal year after the period of availability for obligation of a fixed appropriation account ends, the account shall be closed and any remaining balance (whether obligated or unobligated) in the account shall be canceled. Thereafter, it shall not be available for obligation or expenditure for any purpose.

2. CHARGING CLOSED APPROPRIATIONS TO CURRENT APPROPRIATIONS TO PAY OBLIGATIONS

Since the period of expired availability will be stretched out to five years vice two years, Congress presumed that tighter controls could be placed on this time period. However, a provision to take care of legitimate bills would also be required. These two aspects would be addressed through the employment of fiscal year identity during the five year period and the payment of old bills with current appropriations. The language of this provision is stated under section 1553 of P.L. 101-510:

After the end of the period of availability for obligation of a fixed appropriation account and before the closing of that account under section 1552(a) (as stated above) of this title, the account shall retain its fiscal year identity and remain available for recording, adjusting, and liquidating obligations properly chargeable to that account.

Subject to the provisions of paragraph (2), after the closing of an account under section 1552(a) or 1555 of this title, obligations and adjustments to obligations that would have been properly chargeable to that account, both as to purpose and in amount, before closing and that are not otherwise chargeable to any current appropriation account of the agency may be charged to any current appropriation account of the agency available for the same purpose. The total amount of charges to an account under

paragraph (1) may not exceed an amount equal to 1 percent of the total appropriations for that account.

a. FISCAL YEAR IDENTITY

Congress believed that in order to improve Congressional oversight of expired appropriations and hold agencies accountable, the fiscal year identity would have to be maintained for the five year phase. Senator Glenn concluded that "These accounts, because they would be kept by fiscal year and line item, would have a greater degree of control and financial integrity than the merged surplus accounts." (SCGA Report No. 101-1085, 1990, p.3)

b. USE OF CURRENT APPROPRIATIONS

One concern that needed to be addressed was the status of legitimate expenses after the five year expenditure availability period. Senator Glenn anticipated this problem and queried various DOD representatives and GAO as to the propriety of using current appropriations to handle remaining claims:

Now there are going to be some legitimate expenses after that time (five year availability period) on some programs. Now the way we take care of that is by allowing agencies to pay bills out of current appropriations, subject to a 1 percent cap of current appropriations. (SCGA Report No. 101-1085, 1990, p. 32)

Since most parties agreed that it should be possible to terminate 99 percent of the contracts within five years, to assign one percent of current appropriations for old bills seemed like a reasonable figure. The use of current

appropriations became the remedy for accommodating continuing adjustments.

Additionally, the use of current appropriations for old bills would impose greater controls on DOD managers. Testimony by Mr. Socolar, Special Assistant to the Comptroller General, revealed that:

The control by the Congress would lie in the fact that the current appropriations would have to be used and it would not be possible for the agencies to just draw on the Treasury to make those payments without budget authority. (SCGA Report No. 101-1085, 1990, p. 21)

3. CONTRACT CHANGES

The new legislation established approval requirements for certain contract changes involving additional work. The definition of "contract change" was interpreted in section 1553(c)(3) of the law:

In this subsection, the term 'contract change' means a change to a contract under which the contractor is required to perform additional work. Such term does not include adjustments to pay claims or increases under an escalation clause.

In the case where a fixed appropriation account expires the following is stipulated in the law:

if an obligation of funds from that account [fixed appropriation] to provide funds for a program, project, or activity to cover amounts required for contract changes would cause the total amount of obligations from that appropriation during a fiscal year for contract changes for that program, project, or activity to exceed \$4,000,000, the obligation may only be made if the obligation is approved by the head of the agency (or an officer of the agency within the office of the head of the agency to whom the head of the agency has delegated the authority to approve such an obligation).

In the case of a fixed appropriation account with respect to which the period of availability for obligation has ended, if an obligation of funds from that account to provide funds for a program, project, or activity to cover amounts required for contract changes would cause the total amount obligated from that appropriation during a fiscal year for that program, project, or activity to exceed \$25,000,000, the obligation may not be made until:

The head of the agency submits to the appropriate authorizing committees of Congress and the Committees on Appropriations of the Senate and the House of Representatives a notice in writing of the intent to obligate such funds, together with a description of the legal basis for the proposed obligation and the policy reasons for the proposed obligation; and a period of 30 days has elapsed after the notice is submitted.

4. ANNUAL REPORTING

Addressing the concerns pertaining to improving accountability and control of expired accounts, section 1554 of P.L. 101-510 identifies three elements necessary to assure effective financial management: an annual audit, a report, and implementation of internal controls:

Any audit requirement, limitation on obligations, or reporting requirement that is applicable to an appropriation account shall remain applicable to that account after the end of the period of availability for obligation of that account.

After the close of each fiscal year, the head of each agency shall submit to the President and the Secretary of the Treasury a report regarding the unliquidated obligations, unobligated balances, canceled balances, and adjustments made to appropriation accounts of that agency during the completed fiscal year. The report shall be submitted no later than 15 days after the date on which the President's budget for the next fiscal year is submitted to Congress under section 1105 of this title.

Each report required by this subsection shall:

- a) provide a description, with reference to the fiscal year of appropriations, of the amount in

- each account, its source, and an itemization of the appropriations accounts;
- b) describe all current and expired appropriations accounts;
- c) describe any payments made under section 1553 of this title;
- d) describe any adjustment of obligations during that fiscal year pursuant to section 1553 of this title;
- e) contain a certification by the head of the agency that the obligated balances in each appropriation account of the agency reflect proper existing obligations and that expenditures from the account since the preceding review were supported by a proper obligation of funds and otherwise were proper;
- f) describe all balances canceled under sections 1552 and 1555 of this title.

The head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed to support the certification required by section 1108(c) of this title.

5. AUDIT OF OBLIGATED BALANCES OF THE DEPARTMENT OF DEFENSE

By 1990, the balances in the M and Merged Surplus accounts had reached substantial proportions accumulated for over thirty-five years. However, Rep. Ireland (D-FL) believed that the primary reason for this enormous growth was "that the accounts have never been audited in their entirety." (SCGA Report No. 101-1085, 1990, p.16) Congressional hearings on the M accounts revealed different views regarding a major audit of DOD M and Merged Surplus accounts. Representative Ireland argued that

no account is too big to be audited. I do not think such an account exists, nor do I believe that an account that

cannot be audited should exist. (SCGA Report No. 101-1085, 1990, p.16)

Additionally, Mr. Socolar felt it was "necessary to do a full scale audit in each agency of those accounts in order to establish a base line for the correct recording of obligations." (SCGA Report No. 101-1085, 1990, p. 23) Conversely, testimony from Mr. Vander Schaaf doubted the possibility of an effective audit:

To do a serious audit of both the M Account and the merged surplus account as has been suggested here, is probably impossible. I do not think we could ever really accomplish an audit of the current balances. (SCGA Report No. 101-1085, 1990, p.47)

Evidently, the requirement for an audit of the M account was placed in P.L. 101-510 under section 1406:

Not later than December 31, 1991, the Secretary of Defense shall submit to Congress a report containing the results of the audit conducted pursuant to subsection (a) (audit requirements). The report shall set forth-

- 1) the information required to be identified pursuant to subsection (a); and
- 2) for each appropriation account (A) the average length of time funds have been obligated, (B) the average size of the obligation, and (C) the object classification of the obligations, all shown for total obligations and separately for valid obligations and obligations that are no longer valid.

D. CHAPTER SUMMARY

This chapter focused on congressional concerns regarding the M and Merged Surplus accounts and the reasoning behind the major requirements instituted by P.L. 101-510. The next chapter will review the financial management organization in

DON and how their interpretation of P.L. 101-510, as reflected
in NAVCOMPT Instruction 7040.37B.

IV. DON INTERPRETATION OF P.L. 101-510

A. INTRODUCTION

After the enactment of P.L. 101-510, the guidance for the law flowed from OMB to DOD and finally to the respective services. Since the language of the law was not in financial terminology, there were some implementation problems for the services. The OSD Comptroller sets his own policy guidance and promulgates it to the services. Each service took the OSD guidance and interpreted it according to their own financial management approach. This chapter will discuss the key players in the Navy's financial management organization and synopsize their interpretation of OSD guidance through NAVCOMPT Instruction 7040.37B.

B. FINANCIAL MANAGEMENT ORGANIZATION

Financial management in the public sector is fundamentally different from the private sector in that the profit motive is lacking in most government operations. The initial stage of budget execution starts with the enactment of the Appropriation Act by Congress and the signature of the President. Congress and the federal agencies need to be assured that funds are expended for the intended purpose expressed in the Act.

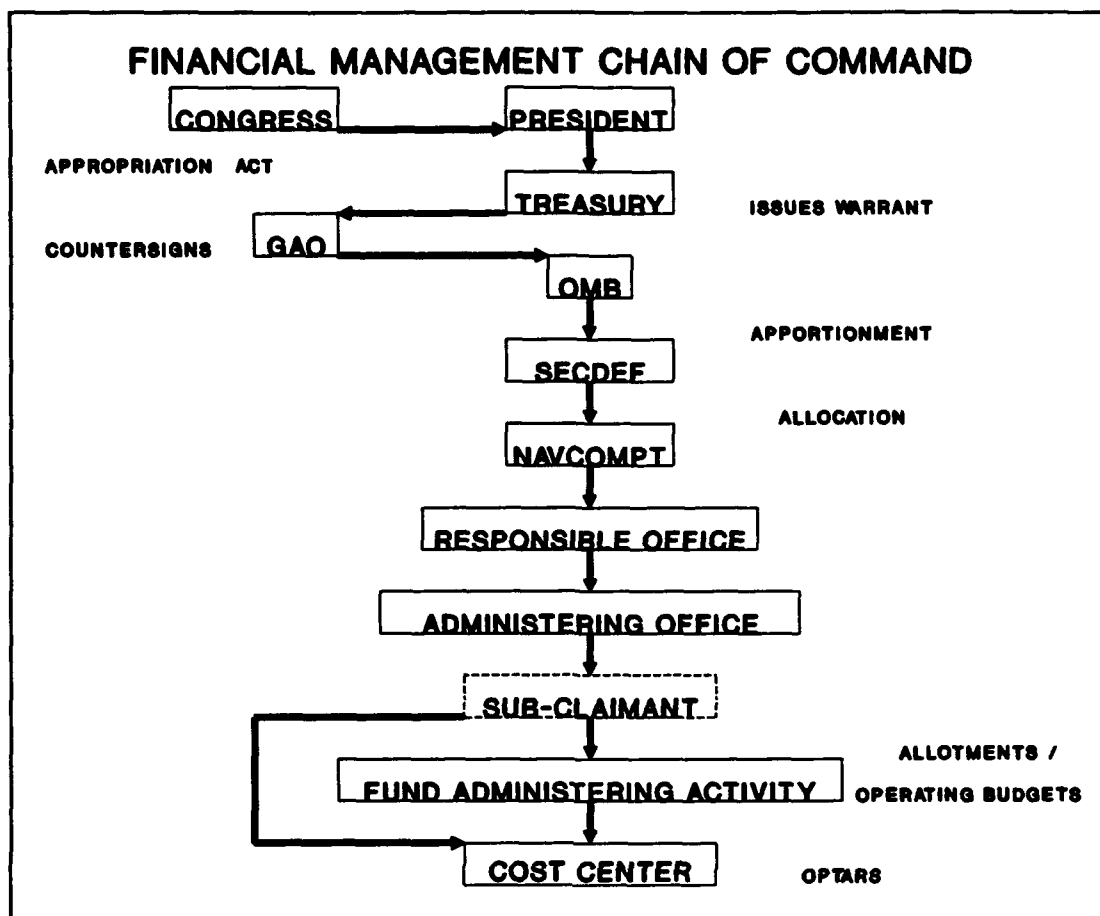


Figure 4.1 DON FINANCIAL MANAGEMENT CHAIN OF COMMAND

The DOD receives funds from OMB in the form of appropriations approved by Congress. These appropriations provide budget authority to incur obligations and to make valid disbursements out of the U.S. Treasury. The DON is apportioned its share of the total DOD budget to execute its programs and to meet its operational and administrative requirements. Key players in the execution of the Navy's budget are shown on Figure 4.1.

The Comptroller of the Navy (NAVCOMPT) determines budget and funding responsibilities among appropriations and

organizational entities of the DON. The establishment of financial responsibility is based upon Comptroller interpretations of various OMB and OSD regulations.

The Responsible Office (RO) has the assigned responsibility for overall management for all programs financed by an appropriation. All Navy funds, except RDT&E and Marine Corps funding, flow through the Office of the Chief of Naval Operations (CNO), the RO for these appropriations. The Commandant of the Marine Corps is the RO for all Marine Corps appropriations and the Assistant Secretary of the Navy (Research, Development and Acquisition) is the RO for RDT&E,N. The RO will then allocate funds to Administering Offices (AO).

The AOs are assigned responsibility by the RO for budgeting, controlling obligations, tracking expenditures, accounting and reporting accuracy for assigned programs financed under appropriations or subdivisions of an appropriation. (PCC, 1991, p.D-8) The AOs are commonly referred to as major claimants. The AO will either suballocate to a Sub-claimant (Type Commander) or allot to a Fund Administering Activity (FAA) in the form of allotments or Operating Budgets.

The FAA is the lowest level at which legal restrictions of the "Anti-Deficiency Act" (Title 31, section 1517) are applicable. Additionally, as an Operating Budget holder, this is the lowest level at which official accounting is performed.

Funds distributed to Sub-claimants are further issued as

Operating Targets (OPTARS) to aircraft squadrons, ships and other staff functions. The OPTAR holder has administrative limitations rather than the legal limitations imposed under Title 31. Therefore, the financial managers at this level are not held legally accountable for overobligations.

C. DON GUIDANCE FOR ADMINISTRATION OF APPROPRIATIONS AFTER THE PERIOD OF AVAILABILITY

This section will synopsise the official DON guidance on accounting for expired accounts, including M and Merged Surplus accounts, in accordance with NAVCOMPTINST 7040.37B.

1. UPWARD ADJUSTMENTS FOR EXPIRED APPROPRIATIONS

The use of unobligated balances for upward obligation adjustments is only available for contract adjustments that are within the scope of the original contract. The upward obligation adjustments that do not involve additional work but only cost are charged to the appropriation originally financing the efforts. Examples of contract adjustments that involve only cost increases include incentive fees, award fees, price escalations, economic price adjustments, and target to ceiling adjustments under Fixed Price contracts.

This policy constitutes a change from prior OSD guidance dealing with upward adjustments. Originally, unobligated balances could be used for upward adjustments that involved additional work and cost.

When dealing with expired appropriation accounts, upward obligation adjustments are not accomplished automatically. Upward obligation adjustments in excess of \$100,000 for individual contracts require higher approval authority depending on dollar amounts. The upward obligation adjustments approval thresholds are summarized in Table 4.1.

TABLE 4.1

DOLLAR THRESHOLDS	APPROVAL AUTHORITY
0 - 99,999	Major Claimant (AO)
100,000 - 499,999	Responsible Office (RO)
500,000+	Comptroller of the Navy
4 million	DOD Comptroller
25 million	Congressional Prior Notification

a. CONTRACT CHANGES

Contract changes are defined as all changes that result in additional billable work and cost and must now be financed with appropriations currently available for new obligations. This definition deviates from the definition of a "contract change" in the new law. The policy of OSD has expanded the term to also include within scope changes as well as any other change that results in additional contract

billable costs. In contrast, obligation adjustments that involve only additional costs are not classified as contract changes.

Obligation adjustments that are classified as contract changes are to be funded from the same program (line item, program element) in currently available appropriations. The one percent limitation, as defined in P.L. 101-510, on the use of currently available funds does not apply to this category of contract change. A contract change may be financed from all appropriations currently available. Since the Aircraft Procurement, Navy (APN) appropriation has a three year life span, a contract change to the A-12 program could be financed in whole or in part from any of the three currently available APN appropriations. This example would require the A-12 procurement program line item to exist in all three appropriations.

Normal reprogramming thresholds will apply for adjustments required for all "contract changes" and "contract adjustments" occurring in currently available accounts. If there is not enough funding in the currently available program or the funding does not exist in a currently available fiscal year, reprogramming actions will be required. These reprogramming actions are subject to existing reprogramming rules including those applying to the establishment of new line items in a fiscal year.

Contract changes for annual accounts may be effected without prior NAVCOMPT approval. These contract changes must be funded within the claimant's currently allocated amounts subject to normal reprogramming rules. If the contract change cannot be funded within the current allocation, the claimant is to submit a request for additional resources to NAVCOMPT.

Contract change requests to procurement and research and development appropriations must be submitted via the RO to NAVCOMPT for review and approval. Contract changes financed by current year appropriations are considered unfunded items and are subject to all current budget policies and procedures governing the use of current appropriations. The contract change request to charge current year appropriations must address the impact of the decreases to the current year program used to finance the contract change, as well as the rationale for effecting the proposed contract change.

b. PROGRAM, PROJECT, OR ACTIVITY

Program, project or activity (PPA) controls stem from P.L. 101-508 of 5 November 1990, and are designed to affect "contracted items." For annual accounts, contracted items are individual financial instruments, e.g., contracts or project orders. Accordingly, the term PPA is applied at the individual document level for annual accounts. For the

procurement and R&D appropriations, the term PPA applies to the P1 and R1 subdivisions of each program year's funding, respectively, regardless of the fiscal year involved⁵. For all other accounts, the term PPA is applied as with the annual accounts, at the program year/document level. Each AO must establish appropriate internal controls and records to ensure compliance with the \$4 million and \$25 million constraints with respect to cumulative adjustments for each PPA, as defined here.

c. OBLIGATIONAL ADJUSTMENTS

Obligation adjustments such as adjudicated claims, contract closeouts, incentive or award fees, price inflation (escalation or economic price adjustments), and foreign currency fluctuation adjustments, do not require prior DoD Comptroller approval or Congressional notification. The documentation for these types of obligation adjustments must contain a statement that the contractor and the Government agree that the changes do not require additional work or authorize or result in additional "billable costs" beyond those which would have occurred without the adjustment.

2. UPWARD ADJUSTMENTS FOR CLOSED APPROPRIATIONS

After the 5th fiscal year of an appropriation's expenditure availability period, the remaining unobligated and

⁵ Allocations for the procurement and R&D appropriations are subdivided on a procurement (P1) and R&D (R1) line-item basis.

unliquidated obligated balances are canceled and the appropriation is closed. Following the cancellation of the appropriation, if it becomes necessary to record an obligation which would have been properly chargeable both as to purpose and amount to an appropriation which has been closed, then the current appropriation available for the same purpose as the obligation to be restored may be charged with that obligation and the subsequent disbursement.

The use of currently available funding to finance payments against closed accounts will no longer be exclusively controlled at the NAVCOMPT level. The AOs will be issued operating targets in each appropriation for these payments, which are subject to the one percent limitation. Accordingly, AOs may approve and finance all such uses less than \$100,000 that are within their operating targets provided that the total of all such payments does not exceed the total amount authorized in the operating target. Adjustments exceeding \$100,000 but less than \$500,000 are to be submitted to the RO for approval. Adjustments of \$500,000 or more are to be submitted to the Assistant Secretary of the Navy (Financial Management) for approval. If it becomes necessary for an AO to exceed its operating target, NAVCOMPT should be requested to provide the necessary authority in accordance with NAVCOMPT INSTRUCTION 7040.37B.

Payments will be made using the appropriate subhead as provided by NAVCOMPT. The AOs are also authorized to

reprogram funds from existing allocated funds to these subheads to cover these payments. These reprogrammed funds are not subject to normal reprogramming rules. It is emphasized that the operating targets provide no additional funding. Funding must be reprogrammed into the subhead from existing funds allocated.

Detailed memorandum records must be maintained, however, to keep these "reprogrammings" separately identified from regular below threshold reprogramming actions. A monthly report is required detailing these transactions so they can be incorporated into the semi-annual Report of Programs (DD-1416).

3. EXTENDED AVAILABILITY FOR SCN AND O&M,N APPROPRIATIONS

a. EXTENDED AVAILABILITY

The Department of Defense Appropriation Acts in recent years have provided authority in the Shipbuilding and Conversion, Navy (SCN) and Operation and Maintenance, Navy (O&M,N) appropriations, respectively, to incur new obligations after expiration of the accounts to complete ship construction and ship overhauls. This authority was provided by the Congress in recognition of the fact that most new ship construction and complex ship overhauls cannot be completed within the respective five-year or one-year availabilities of the SCN and O&M,N appropriations. The extended authority

applies only to new obligations for the specific purposes set out in the language of the two authorities.

b. CONTRACT CHANGES

Contract changes, new obligations, and obligation adjustments that make use of the extended availability granted to the O&M,N and SCN appropriations, may be funded from "otherwise expired" accounts. Allocation holders of O&M,N and SCN funding granted extended availability are to track all obligation adjustments for contract changes on those accounts by PPA. Program, project or activity is defined as the hull number for the O&M,N and SCN appropriations for extended availability.

Public Law 101-510 requires the notification and approval of cumulative upward obligation adjustments classified as contract changes that would be charged to an expired account. Because all contract changes that involve additional "billable work" and cost must be charged to current appropriations, a reporting requirement of \$4 million and \$25 million apply to the extended availability authority of the SCN and O&M,N appropriations.

Therefore, for the SCN and O&M,N appropriations, when such an adjustment would cause the total amount of such charges in any fiscal year for a single PPA to exceed \$4 million, that obligation must be approved by the DOD Comptroller. That adjustment and all subsequent adjustments

(contract changes) for that PPA for that fiscal year - regardless of amount - shall be submitted by the allocation holder to NAVCOMPT for submission to and approval by the DOD Comptroller.

If an adjustment causes the total amount of such charges in any fiscal year for a single PPA to exceed \$25 million, that obligation may be recorded only after the DOD Comptroller submits a notice of intent to make the obligation to the Armed Services and Appropriations Committees of the Senate and House of Representatives, and 30 days have elapsed following submission of the notice. When the adjustment request is submitted to NAVCOMPT by the allocation holder to obtain DOD Comptroller approval of the adjustment, it should include a comprehensive written statement concerning the legal basis and policy reasons for the adjustment that also explains the circumstances, contingencies or management practices that caused the need for the adjustment. These reasons and rationale will be forwarded to the DOD Comptroller for transmission to the Congress.

4. OBLIGATION ADJUSTMENT RECORDKEEPING

The ROs and AOs must establish systems to maintain a cumulative record of upward and downward obligation adjustments by transaction for each appropriation during the five year period. Appropriation controls must be established

by each allocation and suballocation holder to ensure obligations are within unobligated balances.

5. APPLICABILITY OF THE ANTI-DEFICIENCY ACT

One of the constraints affecting appropriation accounting involves dollar limitation. Financial managers must avoid putting themselves in a position where they would overcommit, overobligate, or overexpend funds in any appropriation. The "Anti-Deficiency Act" (U.S. Code 1517) provides the legal limitations for these circumstances. The principal provisions are as follows:

- 1) prohibits any officer or employee from making or authorizing an obligation in excess of the amount available in an appropriation or fund.
- 2) provides that the person who caused the violation may be subject to discipline which may include suspension without pay or removal from office. If action is done knowingly and willfully, that person may be subject to criminal penalties of a fine up to \$5,000 or imprisoned for not more than two years, or both.
- 3) forbids the involvement of the government in any contract or obligation to pay money in advance of an appropriation.
- 4) requires the head of each agency to issue regulations establishing an administrative control system with a dual purpose: first, to keep obligations within the amount of apportionment; and second, to enable the agency to fix responsibility for making obligations in excess of the apportionment. (PCC, 1991, p. A-25)

Before P.L. 101-510, these provisions only applied to the obligational availability period of an appropriation. However, based on DON interpretation of the law, the provisions of the Anti-Deficiency Act are now applicable when total obligations, including adjustments to obligations,

exceed the original appropriation. This will include appropriations both during and after the five year expired period. As provided by NAVCOMPT:

An expired account will become over-obligated, and a violation of 31 USC Section 1517 (subdivision level) or 31 USC Section 1341 (appropriation level), will occur when net adjusted obligations exceed the direct obligational authority of the appropriation. (NAVCOMPTINST 7040.37B, 1991, p.4)

6. UNLIQUIDATED OBLIGATION REVIEW

Fund administrators shall ensure than all unliquidated obligations are reviewed periodically in order to validate all unpaid obligations. These reviews must also be performed in support of the year-end closing statement and associated supplementary schedules.

Each of the various levels of contract and program management retains the responsibility of ensuring that all transactions entered into are appropriately concluded. The responsibility still exists to ensure that services and materials that remain undelivered at the time of expiration are delivered subsequently, or where such deliveries cannot be made, action is taken to terminate contractual obligations and recoup funds. Integrity of the funds must be maintained until such time as all outstanding obligations are liquidated or claims are canceled or liquidated. Financial and program managers at all activities are required to actively review uncompleted contracts, unliquidated obligations, incomplete reimbursable orders, uncollected accounts receivable, and

uncollected travel or pay advances held at their level to ensure the validity of such items.

D. CHAPTER SUMMARY

This chapter reviewed the DON financial management organization and their interpretation of P.L. 101-510, as reflected in NAVCOMPT Instruction 7040.37B. Each Armed service translated OSD Comptroller guidance in a slightly different way. The NAVCOMPT instruction will affect both the investment and expense type appropriations. The next four chapters will examine the Procurement and Operation and Maintenance appropriations, which are the most prevalent appropriations used from these two types of appropriations.

V. PROCUREMENT ACCOUNTS

A. INTRODUCTION

This chapter provides a description of the Navy investment accounts, specifically the Procurement accounts and their relationship with the activities involved in the budget execution of these accounts. It will provide background information on the relationships between the system commands and those responsible for financial control and acquisition management.

B. PROCUREMENT ACCOUNTS

The Navy budget can be broken into five basic appropriations: Military pay and allowances, Operations and Maintenance, Research and Development, Military Construction, and Procurement. Figure 5.1 presents the appropriation segments contained in the DOD Budget for FY 1991. The two primary categories for Navy appropriations are investment-type and expense-type appropriations.

Expense type appropriations finance the cost of ongoing operations within the Department of the Navy and costs are budgeted and financed from two accounts: (1) the Operation and Maintenance appropriations and (2) the Military Personnel appropriations (including those for Reserve components). Expense accounts address issues relating to readiness,

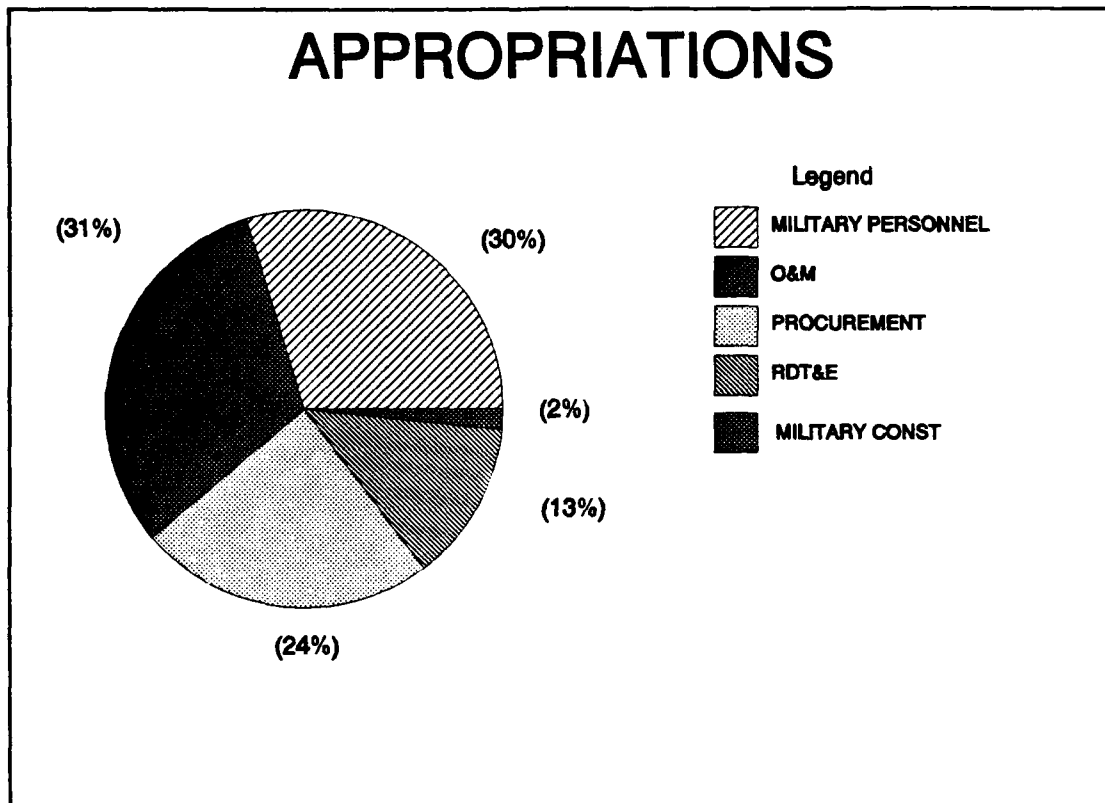


Figure 5.1 DOD BUDGET FY 1991

manpower, and sustainability.

Investment type appropriations finance costs for capital assets of the Department of the Navy such as real property and equipment that provide new or additional capabilities or maintain existing capabilities. Programs budgeted and financed by the Procurement and Military Construction appropriations are considered investment costs. (NAVAIRINST 7070.13D, 1982)

Research, Development, Test and Evaluation appropriations can be categorized as both investment and expense since this appropriation is used to finance ongoing costs of research

efforts which are normally devoted to the development and acquisition on new investment items.

The acquisition process is funded predominately within the investment area of the budget primarily with two appropriations: RDT&E, in which the weapons system is designed and proved through the prototype stage, followed by the Procurement accounts, which fund the production of the end item and related support equipment.

As presented by Figure 5.1, the Navy allotted 37 per cent of the total budget in FY 1991 for acquisition of major programs. Historically, systems commands have carried out these funded programs and provided administration of allocated funds. They were responsible for budgeting and executing with Procurement, RDT&E, Construction, and O&M appropriations.

With the implementation of Defense Management Review (DMR) initiatives, the management structure of system commands have been modified. The Acquisition Executive (ASN[RD&A]) has a stronger role in the oversight of major weapon systems. The DMR established Program Executive Officers (PEOs), within the systems command, to manage major acquisition programs under the oversight and control of the ASN(RD&A).

This DMR initiative lessened the role of systems commands in executing acquisition policies. Commanders of the systems commands will have less control over programs and function as a support organization for PEOs. Therefore, they have to "refocus their missions to three primary roles: managing

acquisition programs not administered by the PEO structure; providing support service to the PEO/PM without duplicating any of their management functions; and providing necessary logistical support." (Golden Wings, 1990)

C. PROCUREMENT FUNDS FLOW

The transaction cycle of funds was summarized in chapter III. The flow of funds for procurement accounts will be addressed in this section. The flow of funds for procurement accounts includes the following appropriations; Weapons Procurement, Navy (WPN), Aircraft Procurement, Navy (APN), Other Procurement, Navy (OPN), Shipbuilding and Conversion, Navy (SCN). Figure 5.2 displays the funds flow for DON. The responsibility for the management of funds within this structure differs with appropriations. There are three Responsible Offices (ROs) in DON: Office of the Navy Comptroller (NAVCOMPT), the Commandant of the Marine Corps (CMC), Assistant Secretary of the Navy, Research, Development and Acquisition (ASN{RD&A}). Starting at the point of NAVCOMPT allocation, Figure 5.3 presents the flow of funds for the procurement account.

1. BUDGET FORMULATION

A complex estimation process is required for major acquisition programs. Procurement appropriations are based on a budget formulation policy which require all programs and weapon systems to be fully funded in the Defense Department.

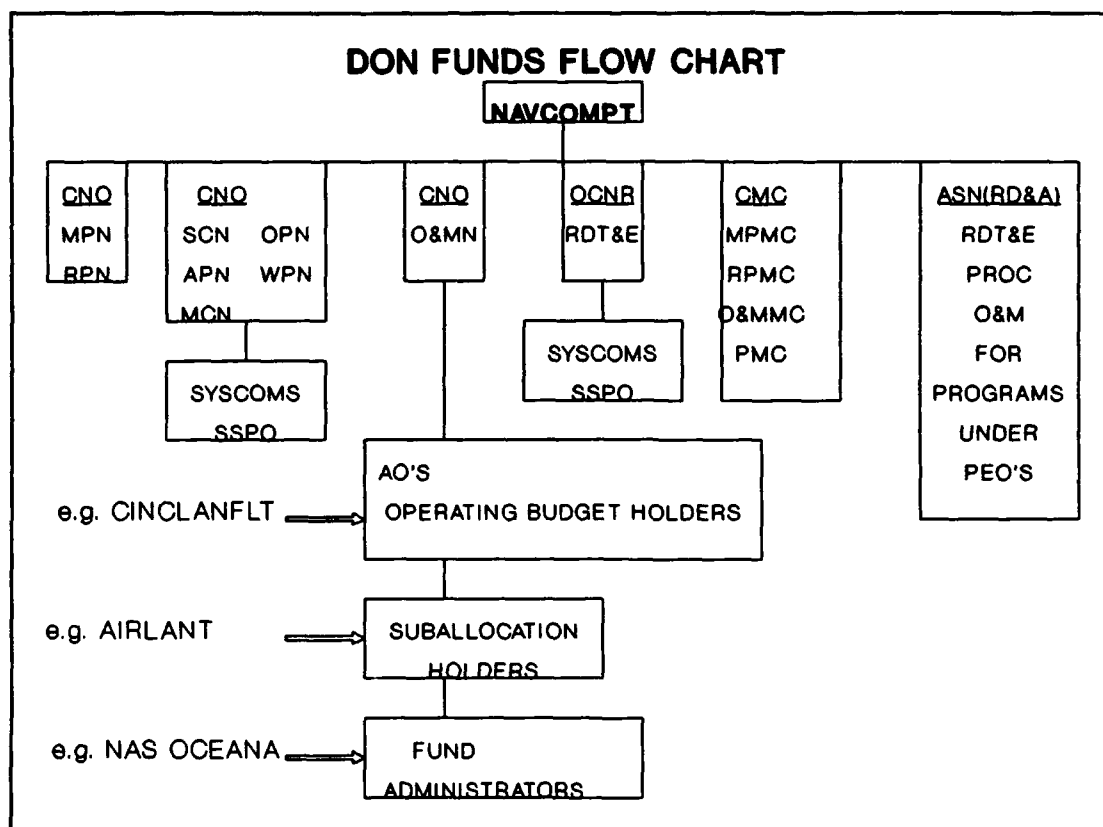


Figure 5.2 DON FUNDS FLOW

The policy of full funding requires every organization to budget in each program year for all procurement costs necessary to deliver complete operational systems to the field. (Harshman, 1982) The procurement programs are structured to continue should future procurement be canceled or terminated. DOD Directive 7200.4 formally states the full funding concept as follows:

Each year's (procurement) appropriation request must contain the funds estimated to be required to cover the total cost to be incurred in the completing delivery of a given quantity of usable end items such as aircraft, missiles, ships, vehicles and ammunition. (DOD Directive 7200.4, 1983)

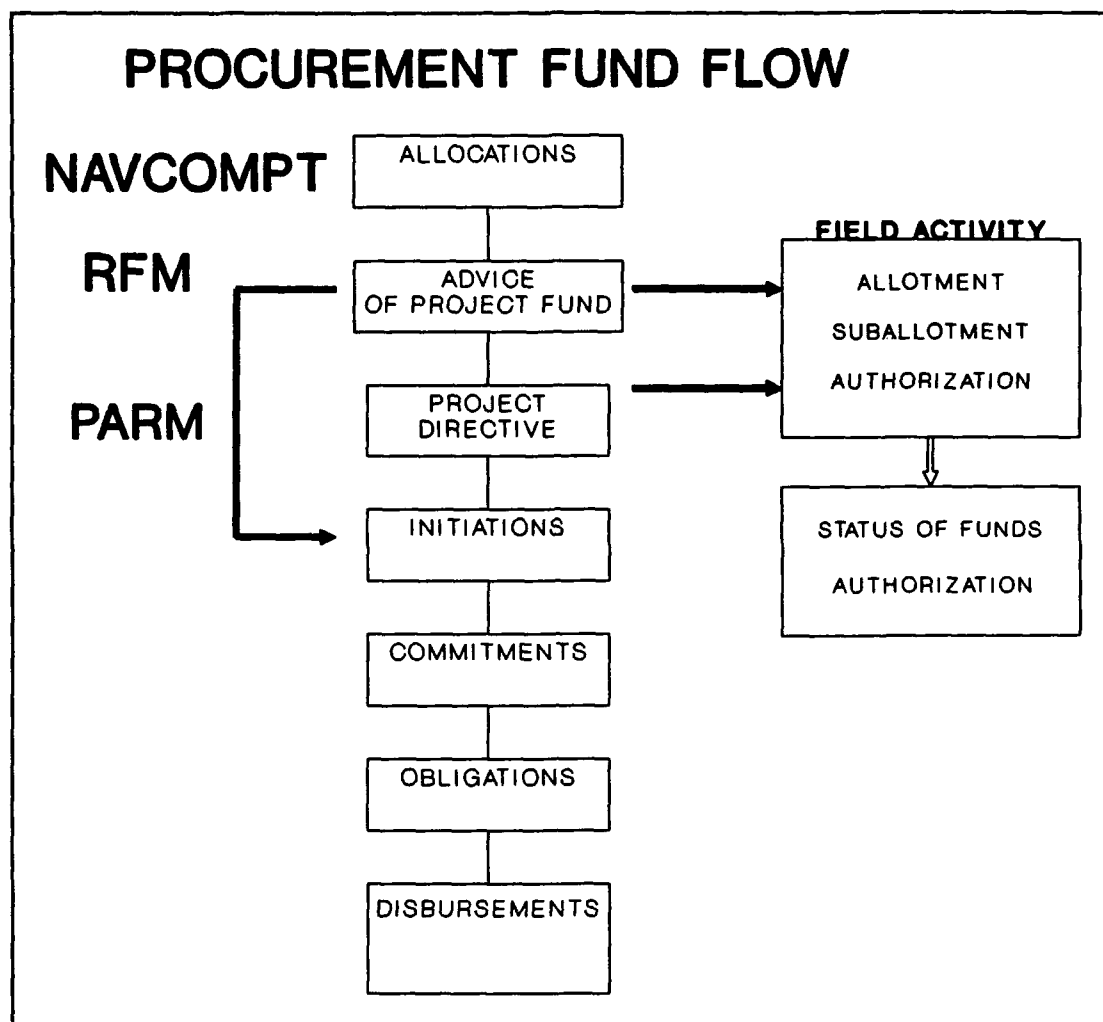


Figure 5.3 PROCUREMENT FUNDS FLOW FOR DON

The full funding policy requires the DON to budget each year for the total costs necessary to complete delivery of the quantity of end items included in the procurement appropriation. Therefore, no piecemeal procurement of subsystems or components is permitted, except under Multi-Year Procurement (MYP).

Full funding articulates a clear budget presentation, identifies procurement quantities, promotes uniform cost

practices, and provides consistent visibility of the program costs. The full funding concept establishes a foundation from which major acquisition systems can be examined in the Defense and Congressional review process.

2. FUNDS FOR BUDGET EXECUTION

This section will discuss the financial chain of command that executes procurement accounts. After budget authority is apportioned to the services by OMB and OSD Comptroller, the flow of funds for Navy procurement begins with the allocation to the Administering Offices (AOs). Basically, allocations convey the obligational authority from NAVCOMPT to the ROs who pass it on to the major claimant.

The Requiring Financial Manager (RFM) has overall responsibility for the delivery of a weapons system or other procurement within cost and schedule goals. The RFM is also known as a Program Manager. The RFM receives a command allocation of obligational authority via an Advice of Project Funds. The RFM may further distribute this authority by 1) using a Project Directive to a Participating Manager 2) issuing an allotment to a field activity or 3) responding to a Headquarters Procurement Requests (PR) as an initiation. An initiation is a non-binding reservation of funds for planning purposes.

The Participating Manager (PARM) is the organization or individual designated as having responsibility for

acceptance and execution of a Project Directive issued by a RFM. A Project Directive is the instrument by which the direction and authority for accomplishment of the planned project effort is promulgated by the RFM. A PARM may be located within the system command, may be an Administrative Contracting Officer or selected field activity.

The allotment/suballotment authorization is used by the RFM and PARM to give funds to field activities if they choose to use field activities to do the procuring of goods and services. In turn, these field activities report the status of their allotments on a monthly basis to their financial offices (Status of Funds Authorization).

Initiations are recorded based on preliminary negotiations which can lead to commitments or obligations. However, it does not reduce fund availability and is not legally binding on any spending authority.

This leads to the recording of the reservation of funds cited on funds usage documents called a commitment. Entering and recording into a commitment on the records of the allotment is to reserve funds for future obligations (PCC 1991). A commitment is based upon firm procurement directives and requests which authorize the recipient to create obligations without further request for certifying the availability of funds. The act of entering into a commitment is a prelude to the establishment of an obligation.

An obligation is a transaction which legally reserves a specific amount of an appropriation for expenditures. It is usually represented as the act of signing a contract or contract-like document, which is legally binding to the Federal Government.

Finally, an outlay is produced and recorded based on the actual payment of funds from the U.S. Treasury. An outlay transaction is usually represented as the cashing of a government check. Outlays result from delivery of end items, supplies, or a defineable effort to the DON. The outlay payment of money is important because it is the monetary concept that measures the effects of federal spending on the economy, and in particular it is the monetary measure of the size of the federal deficit. (Waelichli, 1984)

D. CONTRACTING PROCESS

This section will discuss those who are responsible for overseeing the contract administration and performance of major programs. Contract administration is a management process to ensure the contractor delivers the supplies or services on time, goods or services delivered are of the quality required by the contract, and costs are reasonable. Contracting with DOD is accomplished by individuals specifically empowered to act as an agent, to obligate, or commit the government in a contractual relationship. This authority is given through the contracting officer's warrant,

a document that signifies that the individual has been determined to be qualified and knowledgeable and will be ethical in his/her business dealings for the government. (PCC, 1990) There are three types of contracting officers in DOD.

1. Procurement Contracting Officer (PCO) -- has overall responsibility for the contract, but specifically involved in the activities leading up to and including award of the contract.
2. Administrative Contracting Officer (ACO) -- at the point of performance, such as a factory, the principal Government agent is the ACO. The ACO is responsible for the post-award surveillance of the contractor for the PCO and the Project/Program Manager by performing all those functions related to monitoring the contractors conformance to standards.
3. Terminating Contracting Officer (TCO) -- responsible for the settlement of terminated contracts.

1. CONTRACT ADMINISTRATION

Upon the execution of a contract, the focal point becomes the contractor's plant and the objective is assuring contractor performance. For the Defense Department, the Defense Contract Management Command (DCMC) is responsible for providing contract administration services.

In 1965, the Secretary of defense established the Defense Contract Administration Services (DCAS) to provide uniform contract administration services for Department of Defense organizations. In 1990, DCAS was reorganized and DCMC was designated as the single contract administration organization for DOD. DCMC is subdivided into nine districts designated Defense Contract Management Districts (DCMD). Each

district is a middle manager between the military services and the Defense contractor. The DCMC maintained a directorate responsible for payment to contractors for material and services rendered. This directorate has an automatic data system to track contracts and supply financial and status information on contracts.

The DCMD accounting responsibilities include insuring that appropriations cited as financing the contracts are not overdisbursed and that payments are made promptly. To prevent overpayment, the regions need accurate obligation data from the military services on each appropriation for each contract. As payments are made, the districts report detailed payment accounting data to the DOD accounting and finance centers. The accounting and finance centers then provide this data to the systems commands. The military services must match the payments with the obligations to effectively fulfill managerial control over appropriated funds as required by (31 U.S.C. 665). Correctly matching payments with obligations provides the military services with the accurate status of program expenditures to aid program managers in ongoing decision making. Payments charged to incorrect appropriation accounts and processing errors can distort accounting reports that the Navy uses to make management decisions on the budget execution for individual appropriations and that Congress uses to review the Navy budget.

2. INACCURATE RECORDS

Financial transactions have proven to be inaccurately processed among the systems that account for Department of Defense appropriations. Data errors can occur in many ways. For example, data entry or accounting technicians can make mechanical errors, misinterpret, or misread contract data when entering the data into the computer system. Military Standard Contract Administration Procedures (MILSCAP) were supposed to overcome the problems associated with nonstandard information; however, DOD has been slow in fully implementing these procedures. These standards are designed to simplify, standardize, and automate the processing of procurement, contract administration, and financial data to minimize errors. (GAO FGMSD-80-10, 1980)

The GAO conducted a management review of DLA and noted the primary danger with inaccurate data which DCAS Regions were reporting to DOD funding activities,

Because funding activities base their accounting record adjustments on the data they receive from DCASRs, incomplete, inaccurate, or otherwise erroneous contract transaction data hinder the activities ability to control and report on the status of appropriated funds. Funding activities use the transaction data to match payments with obligations in order to maintain administrative control over appropriated funds. In addition, matching payments with obligations provides program information needed for making management decisions and for certifying to the accuracy of ULO (Unliquidated Obligation) balances. (GAO NSIAD-86-64, 1986, p. 68)

E. NAVY ACCOUNTING SYSTEM

The DOD accounting systems are receiving extraordinary emphasis and attention. A major goal of the OSD Comptroller beginning in 1987 has been to accelerate compliance with Comptroller General standards. Out of 13 primary accounting systems, the DON has seven accounting systems which comply with the Comptroller General standards. The Navy General Accounting System (NGAS) is the system that handles single consolidated accounting for DON. It provides overall accounting for both the Navy and Marine Corps and maintains centralized budget execution reporting and other department wide financial related activities. Supporting the NGAS, there are least 25 operational accounting support systems. The Standard Accounting and Reporting System (STARS) is one the systems which support NGAS. (NAVCOMPINST 7000.39D, 1990)

The Standard Accounting and Reporting System (STARS) is an operational accounting support system that was implemented to provide a unified financial processing system for users to efficiently carry out their financial management responsibility. This financial management system is used by over 3,000 customers from headquarters and field activities. These users include the various Naval Systems Commands, NAVCOMPT, CNO, SSPO, SUPSHIPS, DPROS, other major claimants and NRFC.

The STARS was designed to account for the following appropriations: Procurement, RDT,&E,N, O&M,N. The major purposes of STARS include:

1. Consolidation of administering and operating budget accounting functions
2. Integration of disbursing and accounting functions
3. Improvements in
 - A. Data base design
 - B. Financial reporting
 - C. Financial controls
 - D. Interface with other systems (NAVCOMPT 7000.39D)

The STARS has evolved from other systems to provide the capabilities that exist today. In 1974, the system command unique automated procurement systems converted to PARS (Procurement Accounting and Reporting System), which was the first on-line system. In 1981, PARS converted to STARS by the inclusion of appropriations O&M,N, O&M,NR, R&D. STARS could now account for all the appropriations used by the weapon system at the system command level. In 1988 STARS converted to STARS HCM (Headquarters) which provided distinct administering office accountability for each supported claimants.

However, STARS has been cited as being noncompliant to Comptroller General guidelines. The following are material deficiencies observed of the STARS system:

- a. Accounting for receivables including advances -- amounts owed by contractors are not included in accounts receivable. Therefore, interest, penalties, and administrative costs must be manually charged because STARS lacks the capability.
- b. Accrual accounting-- STARS does not perform accrual accounting, especially concerning accounts payable.

- c. Systems control -- STARS cannot report an overobligation of funds in violation of 31 U.S. Code 3512 which requires complete disclosure of financial results.
- d. Audit trails -- STARS lacks adequate audit trail to trace transactions to individual users of STARS.
- e. Cash procedure and Accounts payable -- incurred liabilities are not accounted for and reported in STARS irrespective of whether funds are available for payment.
- f. System operations -- STARS does not have a system-wide ADP Security Plan with a detailed Plan of Action and Milestone (POA&M) as required. It also lacks a Top Secret Security Package with user passwords and identification of authorized user.
- g. User information needs -- STARS does not provide FMS data in the necessary format for MISIL processing and proper control and matching of disbursement and deliveries. (NAVCOMPTINST 7000.39d, P.113)

VI. IMPACT ON PROCUREMENT ACCOUNTS

A. INTRODUCTION

The M account has provided funding flexibility by ensuring the DON appropriations had availability of funds beyond their obligation limitation dates (see Figure 2.1). The cancellation of the M account affects many aspects of financial and contract management business for both government and industry from contract changes to contract closeout. The cancellation of M accounts is taking place in phases as shown in Figure 6.1. How will business be conducted now that the phase-out process is taking place? Financial managers and contract administrators are working to adapt to the new restrictions regarding expiration of obligated funds.

System commands will lose the ability to correct financial problems using prior year funds. Naval Air Systems Command recently reviewed some contracts and observed the following problems facing managers due to disestablishment of the M account:

- 1) Obligations in STARS do not match obligations on contractual documents and are materially overstated/understated.
- 2) Expenditures have been posted to the wrong contracts or cited incorrect type of funds (i.e.,

SCHEDULE OF M ACCOUNT LIQUIDATION

FOR PERIOD ENDING 30 SEPT 91

<u>APPN</u>	<u>FISCAL YEAR</u>
O&MN	FY 84
RDT&E	FY83
APN WPN OPN	FY82
SCN	FY80

FOR PERIOD ENDING 30 SEPT 92

<u>APPN</u>	<u>FISCAL YEAR</u>
O&MN	FY85
RDT&E	FY84
APN WPN OPN	FY83
SCN	FY81

FOR PERIOD ENDING 30 SEPT 93

<u>APPN</u>	<u>FISCAL YEAR</u>
O&MN	FY 86 THROUGH 88
RDT&E	FY 85 THROUGH 87
APN WPN OPN	FY 84 THROUGH 86
SCN	FY 82 THROUGH 84

Figure 6.1 SCHEDULE FOR M ACCOUNT ELIMINATION

O&M,N bills paid with APN funds).

- 3) There have been contractual actions which have been negotiated by NAVAIR or by the ACO and have not been definitized in a timely manner. These contracts may increase obligations and are not visible in the system due to lack of definitization. (Shields interview)

These problems are similar among the all the system commands. Among the new demands presented by the cancellation of the M accounts: 1) using one per cent of current funds 2) restrictions on contract changes 3) role of contract close-out deobligating funds. Nevertheless, with the elimination of the M account, new ways of doing business will have to be developed. This chapter will explore these issues impacting managers and how financial and acquisition policies may change in the future.

B. USE OF CURRENT FUNDS

The most important question being asked by managers who deal with procurement funds is how will the disestablishment of the M account affect current year programs ? As Jerry Smithey, Director of Financial Management Policy at NAVSEA stated,

The big question is how will outstanding bills affect current year dollars? How will they tax other current programs and how can I budget for that one percent? (Smithey interview)

As a result of canceling the M account, DON financial managers must fund prior year upward adjustments and unliquidated obligations with current year funds.

Public-law 101-510 puts a strong emphasis on financial management and contract administration. The debate surrounding the use of "current" funds to pay for old obligations is that such payment will divert spending from a

project/purpose for which the current funds are programmed. Using current funds for prior year obligations may create additional current funding shortfalls for the project/purpose from which the funds are taken.

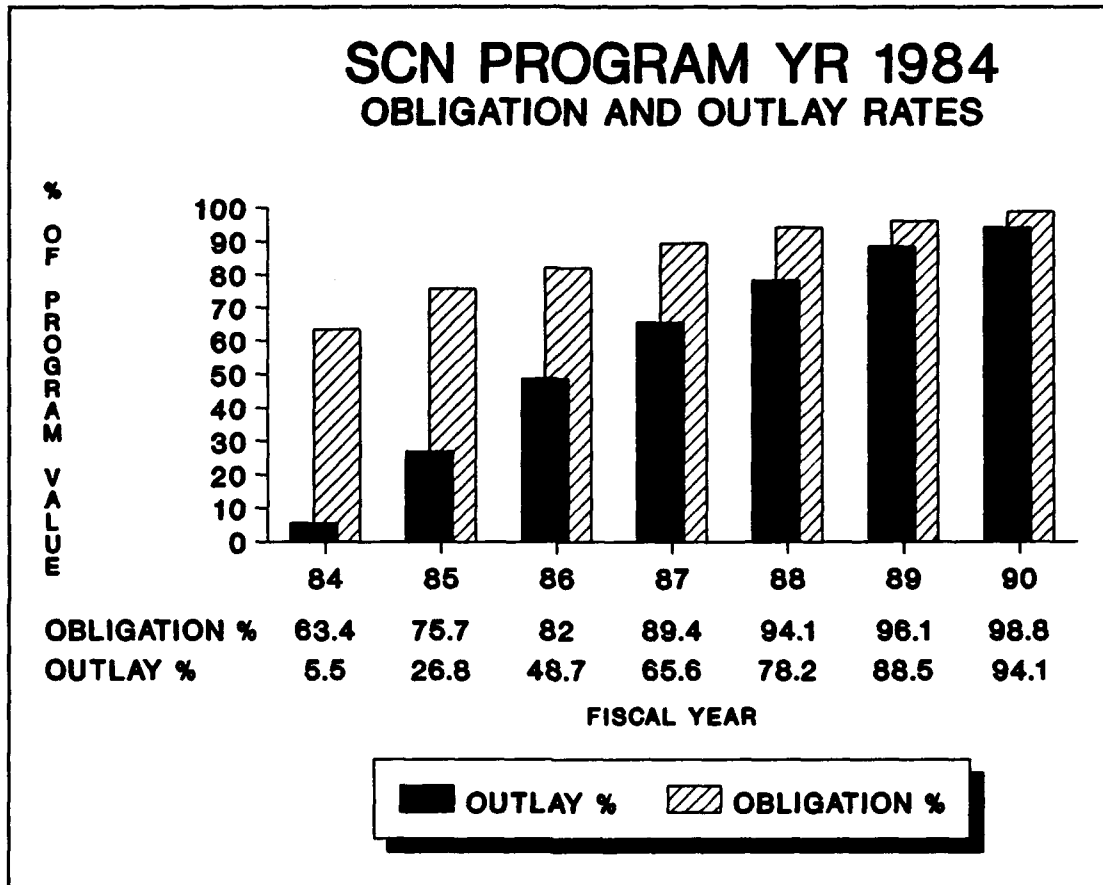


Figure 6.2 SCN FOR PROGRAM YEAR 84

Figures 6.2, 6.3, 6.4 and 6.5 display the obligation and outlay rates based on historical data for Navy procurement appropriations before they were to lapse into the M account. The outlay rates reveal that by the time the appropriations are prepared to lapse into the M account, the large majority of the funds in the appropriation have been expended (90+%).

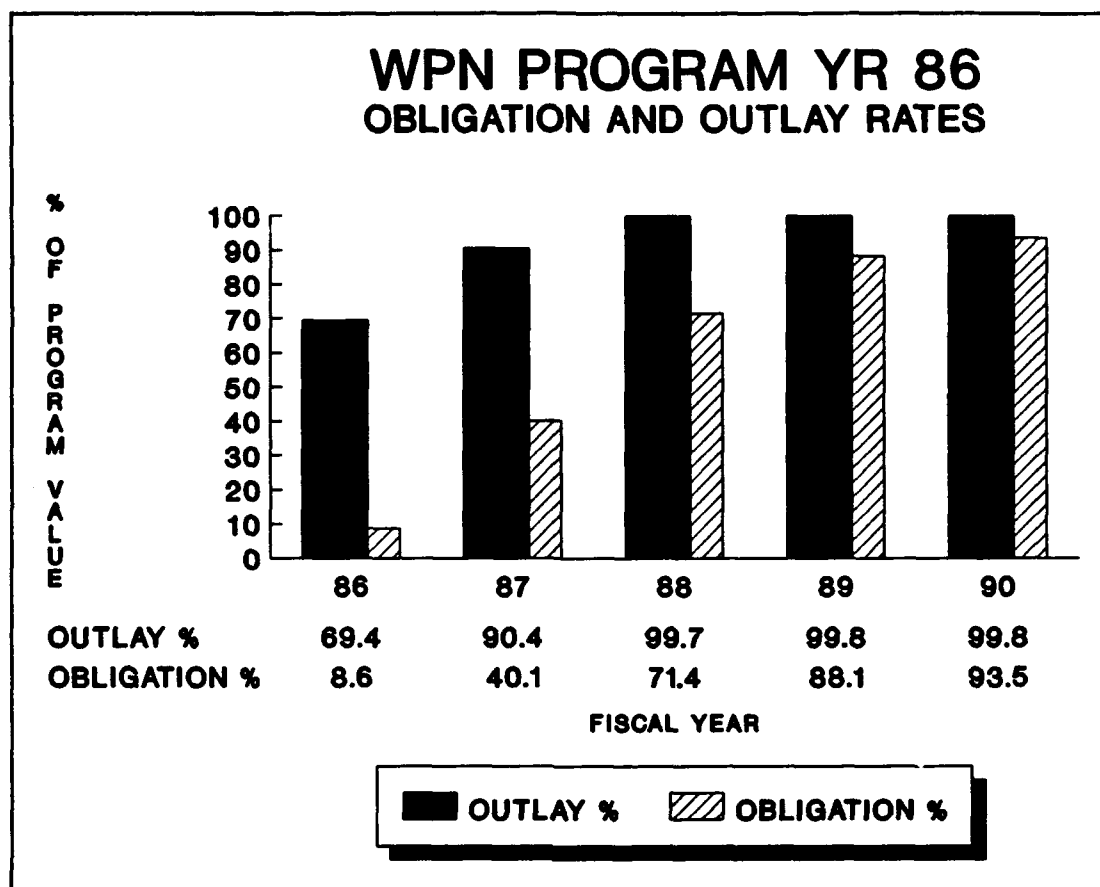


Figure 6.3 WPN FOR PROGRAM YEAR 86

Moreover, the data is based on the previous process of a two year expired period and excludes the extra three years of the expired period that would be initiated by P.L. 101-510.

This analysis does not include the number of obligations that may be invalid. An audit on the M account was conducted by the audit agencies of each Armed Service and passed on to DOD IG. Tom Herlihy, who directed the Naval Audit Service audit, claimed that in the Navy sample "at least 60 % of the M account obligations were invalid." (Herlihy phoncon) Therefore, the impact from prior year obligations may not be

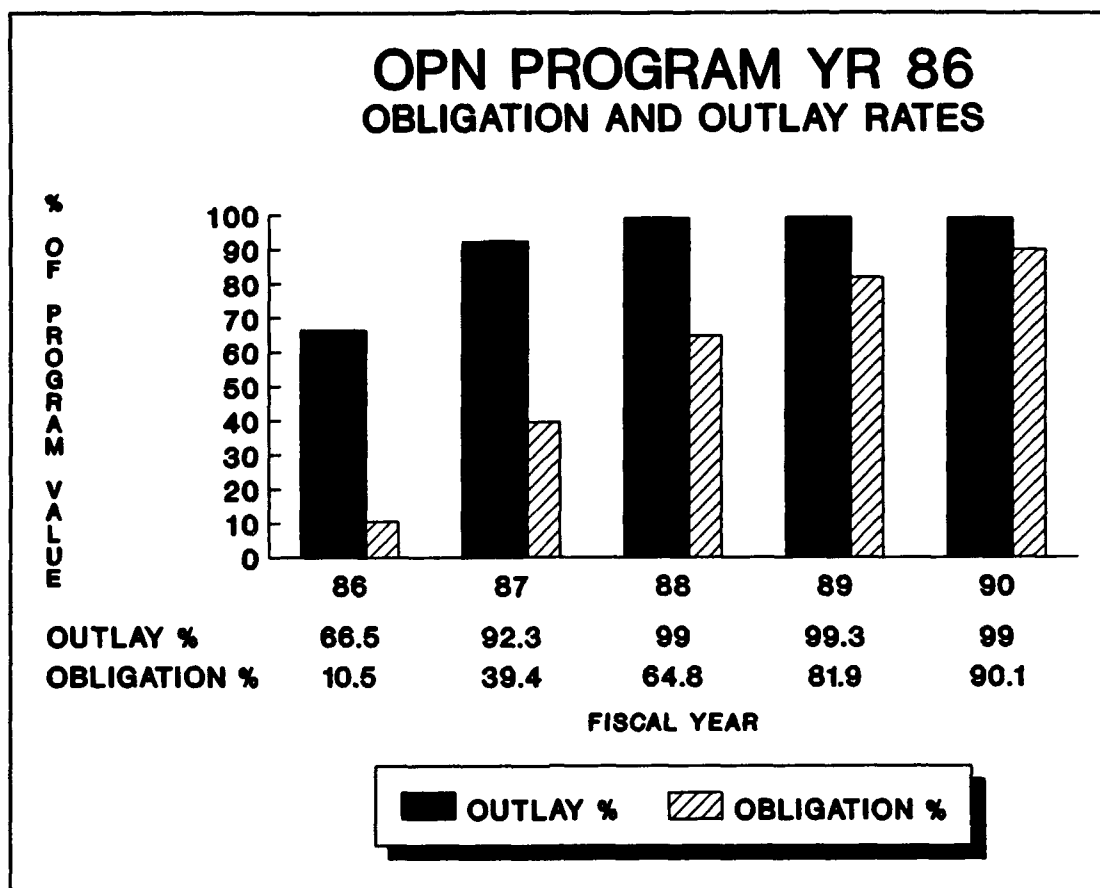


Figure 6.4 OPN FOR PROGRAM YEAR 86

as great as anticipated DON financial managers.

Nevertheless, contracting managers are averse to paying past obligations with current appropriations and are expediting the audit procedures to close out older contracts before the funds that were obligated on them are abolished. As prior year funds are canceled, contractors can expect to encounter increasing inflexibility from the government on cost allowability questions and claims. This change situation may force more contractors to resort to litigation.

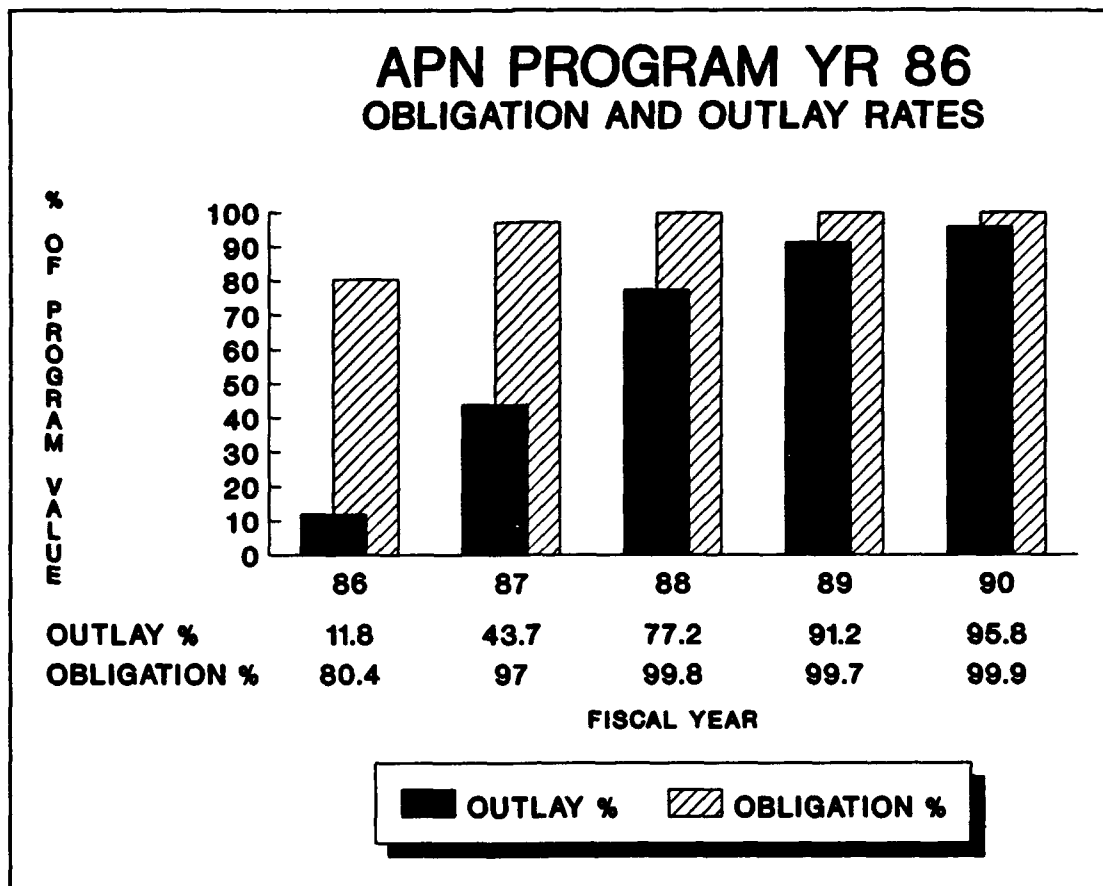


Figure 6.5 APN FOR PROGRAM YEAR 84

Through the policy of full funding, procurement programs are structured to "stand alone" and continue should future procurement be canceled or terminated. If current funds were to be taken away to fund prior years, policies concerning the full funding concept may also be impacted. Without the flexibility of an M account to fund increases in valid obligations, the acquisition planning process will have to be more precise and/or add additional time to permit obtaining supplemental appropriations. (TIPS, 1991)

C. CONTRACT CHANGES

The proposal that may have a greater impact on current funds than the paying of prior year obligations is the new restriction on contract changes. Contract changes are defined as all changes that result in additional billable work and cost to be financed with current appropriations available for new obligations. The OSD policy has expanded the term to also include within scope changes as well as any other changes that result in additional contract billable costs. In contrast, obligation adjustments that involve only additional costs are not classified as contract changes. NAVCOMPT Instruction 7040.37B elaborates that,

Prior Year antecedent liabilities that are within scope obligation adjustments that do not involve additional work but only cost are charged to the appropriation originally financing the efforts. Examples of antecedent liabilities that involve only cost increases include incentive fees, award fees, price escalations, economic price adjustments, and target to ceiling adjustments under Fixed Price contracts. (NAVCOMPINST 7040.37B)

Obligation adjustments that are classified as contract changes are to be funded from the same program (line item, budget activity, program element) in currently available appropriations. A contract change may be financed from all appropriations currently available. (NAVCOMPT Instruction 7040.37B)

These new guidelines present two problems. First, obligation adjustments that are classified as contract changes are to be funded from the same program (line item, program

element) in currently available appropriations. This could present a dilemma with a contract change whose funding requirement (line item, program element) does not exist in the currently available fiscal year.

The other problem is that about 85 per cent of all cost growth can be attributed to changes made to a program (i.e., change in program requirements, quantity, support, schedule, and engineering). (McNichols, 1983) With the change in the definition of "Contract Change", viable adjustments to contracts due to program changes may adversely increase the need for current funds. If there is insufficient funding in the currently available program or the funding does not exist in a currently available fiscal year, formal reprogramming actions may be required.

By analyzing the amount of funds that were restored from the Surplus funds between 1985 and 1990, we can see that a substantial amount of funds that were available for upward adjustments will no longer be available. We analyzed NAVCOMPT data relating to this period and separated those adjustments that would fall under the new definition of "contract change. These adjustments would include Reprocurement for Defaults, Request for Equitable Adjustments (REA), and Engineering Change Proposals (ECP). Table 6.1 reflects the amount of Navy procurement and NAVSEA overhaul funds restored out of the Surplus fund from 1985 to 1990 due to additional work.

TABLE 6.1

FISCAL YEAR	PROCUREMENT	NAVSEA (O&MN)
1985	49,642	4,432
1986	34,299	10,511
1987	43,575	38,164
1988	23,042	24,544
1989	50,446	41,454
1990	15,180	10,490

Memorandum of Agreements (MOAs) are signed by government officials authorizing the contractor to continue work or initiate effort and promising that definitive contract modifications will be issued. The definitization of contracts has created a problem for system commands. Because "within scope" definitizations do not require additional work, expired funds can be used for upward adjustments relating to these transactions. However, in a recent audit conducted by GAO, the Navy (specifically NAVAIR) was cited for not definitizing modifications in a timely manner. (GAO NSIAD-91-156). Although the procedures used by NAVAIR were legal, they were seen as using poor management practices when they neglected to definitize the contract in a timely manner.

There have been contractual actions which have been negotiated by NAVAIR or by the ACO and have not been definitized in a timely manner. Therefore, unpriced ceiling orders have been issued under P mods⁶, definitized under A mods⁷ and the difference in funding has not been obligated. There are undefinitized contractual actions entered into by the Government which may increase our obligations and are not visible in the system due to lack of definitization. (Shields interview)

Naval Air System Command acknowledges the problem with definitization and is attempting to rectify that situation. Pat Shields, PCO F-18 program, states:

There seemed to be a lack of communication between the ACO, comptroller, contractor, and the PCO. We are attempting to ensure that contracts are definitized in a timely manner. (Shields interview)

With M account funds canceled and more stringent guidelines placed on the use of expired funds, contracting officers are likely to be more cautious about either seeking or agreeing to contract changes unless additional appropriations are made available. Contractors will also need to closely monitor work requirements and be wary of constructive changes.

⁶Contract modification initiated by the PCO's

⁷Contract modificationa initiated by the ACO.

D. CONTRACT CLOSEOUT

Contract closeout is the final process of contract administration performed to ensure that the contractor has complied with all the contractual requirements and that the government has also fulfilled its obligations. The closeout process completes all the individual actions initiated during the contracting process.

As a general rule, closeout starts when a contract is terminated or the contractor has delivered and the Government has accepted the equipment, deliverables, or services. The contract is then determined to be physically completed. All closeout activities are linked to this "physically complete" date. A contract is physically completed when both the Government and the contractor agree to the following: 1) the contractor has completed the required deliveries, performed all services and the Government has inspected and accepted the material and services; 2) The Government has given the contractor a notice of complete termination; or 3) when all option provisions in the contract have lapsed (FAR 4.804-4).

A contract is fully closed only when it is both physically and administratively complete. After contracts are physically completed, the ACO conducts the closeout process to provide reasonable assurance that all financial and property transactions have been completed, and that Government resources have not been lost through fraud, waste or mismanagement. The term administratively complete means

that the ACO closes the "administrative contract files". The ACO is not closing the contract, only the administrative files. However, regardless of the dollar amount, a contract should not be closed while in litigation, or while an appeal is pending before the Armed Services Board of Contractor Appeals.

The closeout process becomes more difficult as the dollar value of contracts increases and complex types of contracts are used. Closeout can be a long and tedious process due to the numerous actions that need to be executed and the various activities involved. The process can require actions by several different activities such as contracting offices, receiving activities, ACO's, finance offices, as well as DCAA and DCMAO.

First, the contractor must identify all his costs, determine his actual cost rates and submit his cost proposal to the contracting officer. Then a Government audit, usually by DCAA, is conducted to verify contractor costs. The contracting officer negotiates final cost and overhead rates with the contractor based on the results of the Government audit. These steps can be extremely time-consuming.

The Government has established standard time frames for contract closure action. The purpose of these time frames is to foster the timely and efficient close-out of contracts. These closeout time standards vary with the type of contract involved:

- a. Small Purchase -- considered closed upon PCO notification of final delivery receipt and final payment
- b. Firm-Fixed-Price Contracts -- 6 months after physical completion
- c. Cost Type contracts-- 36 months after physical completion
- d. All Other Type Contracts-- 20 months after physical completion (FAR 4.804-1(a))

The more complex type contracts (those that are not Firm Fixed Price) have longer closeout times because the government has agreed to compensate the contractor for his practical allocable and allowable costs in agreement with the terms of the contract. These costs are not usually determined at the time of physical completion of the contract.

Contract closeout is an often overlooked aspect of contract administration. Once the final deliveries are made and accepted, the level of interest shifts from the physically completed contracts to the award and obligation of new contracts or to the performance of active contracts. The execution priority from higher headquarters is to award contracts and obligate funds.

Untimely contract closeout can have adverse effects on the Government. Because the M account was frequently used to make final payment after contract closeout, the elimination of the M account may have a serious impact on contract closeout. In many organizations, contract closeouts have been accelerated

as a direct result of cancellation of the M account. More specifically, DCMC and DCAA are accelerating contract closeouts. (Federal Contracts Report Feb 1991)

With the declining budget and the elimination of the M account, the deobligation of funds has increased in importance. The Government needs to recover excess funds on physically completed or inactive contracts as soon as possible and make them available for further program use. Unused and unneeded funds can be lost if contract closeouts are delayed causing deobligations to occur after the funds have expired.

System commands are attempting to develop procedures to recover excess funds. For example, NAVAIR attempted to coordinate Program Offices, ACO's and contractors to effect the initial close-out phase. Basically, a closed-loop process to monitor future close-out phases was standardized. Key to this effort is capturing all unliquidated M account funds and managing their final expenditure prior to the established account cancellation deadlines.

E. EXTENDED AVAILABILITY OF SHIPBUILDING AND CONVERSION, NAVY

The appropriation Shipbuilding and Conversion, Navy finances the construction of new ships and conversion of existing ships. The SCN appropriation is a multiple-year appropriation to remain available for obligation for five fiscal years. However, additional obligations may be incurred after the five-year limitation for those work elements

performed in the final stages of ship construction. The extended availability is authorized to cover those items which are essential to delivering a complete ship. For a basic ship construction or conversion project, the obligation and work limiting date (OWLD) is established as 11 months following completion and fitting out (CFO) of the ship.

Department of Defense Appropriations Act for 1984 (P.L. 98-211) incorporated procedures which allow the obligation of funds appropriated for the SCN appropriation to continue after the expiration date of the appropriation provided that the obligation are for "budgeted work that must be performed in the final stage of ship construction" and " is applicable only to such work included in original ship construction program for which funds were appropriated. Any change in ship specifications, not otherwise covered by budgeted change order allowances constitutes new scope work and must continue to be covered by cost growth budget requests." (NAVSEAINST 7000.12, 1984)

This authority was provided by the Congress in recognition of the fact that most new ship construction and complex ship conversions cannot be completed within the respective five-year life for the SCN appropriations. The intent is to limit the need for future reappropriation requests.

According to the new DOD guidelines, the life of the SCN appropriation lasts ten years, five years during the obligational period and five during the expired availability

period. This restriction creates a problem for ships that have lengthy construction times. In the past, the OWLD for ship construction was the date at which extended availability expired. However, the OWLD for ship construction on aircraft carriers, in particular, extend to eleven years. Consequently, after the ten year mark, all unobligated balances are no longer available. NAVSEA managers responsible for future CVN construction will have to augment final contract action to adhere to this new funding profile for the SCN appropriation.

F. CHAPTER SUMMARY

Chapter V and VI reviewed the Navy Procurement accounts and analyzed the issues impacting these accounts with the demise of the M account. These chapters provided background information on these accounts and their relationship with the activities involved in the budget execution of these accounts. They also described the relationships between the system commands and those responsible for financial control and acquisition management. The next two chapters will address specific background data for the Operation and Maintenance accounts. Furthermore, Chapter VIII will analyze the problems encountered by fleet level financial managers in adjusting to the elimination of the M account.

VII. THE OPERATION AND MAINTENANCE ACCOUNT AND THE M ACCOUNT

A. INTRODUCTION

This chapter discusses the Operation and Maintenance, Navy (O&M,N) appropriation and its relationship with primary funding activities in the budget structure of the DON. It will provide background information on the relationships between the operational forces (task forces, ships and aircraft), the sub-claimant (type commander), Financial Information Processing Center (FIPC), and the major claimant. Additionally, a review of the M account and how it interfaces with the operations account will be discussed.

Finally, this chapter will look at the flow of funds at the O&M,N level. It will also provide a historic and future perspective of the DON financial management system and its associated accounting and disbursing network.

B. OPERATION AND MAINTENANCE, NAVY ACCOUNT

The DON utilizes numerous appropriations to incur obligations and to make payments out of the U.S. Treasury for specified purposes such as Research and Development, Procurement, and Military Personnel. However, the basic funding appropriation supporting most naval ashore activities and fleet operating forces is the Operation and Maintenance, Navy account. This "expense-type" appropriation constituted

approximately twenty eight percent of the DON Total Obligational Authority (TOA) in fiscal year 1990. (VADM Mauz Briefing, 1991)

The O&M,N appropriation finances the basic day-to-day operation of the operating Fleet and principal shore commands. It is normally issued as Operating Budget (OB) for normal expenses incurred in the operation and maintenance of an ashore activity, or as Operating Targets (OPTAR) to afloat units. Some of the authorized expenses include salaries of civilian federal employees, contract services for rental and maintenance of equipment, facilities, and real property, consumable supplies, repair parts for weapons and equipment, ship steaming hours, aircraft flying hours and personnel training.

The O&M,N appropriation is an annual account with a statutory time limitation. As an annual appropriation, funds are available for incurring obligations only during the fiscal year specified in the Appropriation Act. Thus, FY 1991 O&M,N funds received by naval activities must be obligated within that fiscal year. Prior to P.L. 101-510, obligated funds which are unliquidated at the end of three years will lapse into the M account, while the unobligated balances will be transferred to the Merged Surplus account.

When obligated (but unexpended) O&M,N balances lapse into the M account, the unexpended balances legally lose their fiscal year identity for outlay purposes. However, they

remain available for the payment of obligations applicable to the original appropriations for the same general purposes as authorized. Thus, the M account is available indefinitely for the payment of obligations chargeable to any of its predecessor accounts.

At the operational level, afloat commands are required to maintain financial records for three years (one year of obligational availability period plus two additional years of expenditure availability period), after which records are no longer required. (NAVSO P-3013-2, 1990, p. 4-12) Any valid transactions (unliquidated obligations) requiring payments from the M account will normally be forwarded to FAADCPAC, or through the chain of command to NAVCOMPT. The M account is centrally managed within DON by NAVCOMPT. Thus, all payments from the M account require approval from NAVCOMPT.

However, P.L. 101-510 significantly changed the management of expired appropriations by phasing out the existing M account and the Merged Surplus authority. The M account will be eliminated by the end of fiscal year 1993. Effective immediately, no additional obligated balances will be transferred to the M accounts. Instead, beginning with FY 1989, separate appropriations for specific expired accounts will be maintained for five years after they expire for purposes of adjusting obligations and making disbursements.

Figure 7.1 illustrates the O&M,N life cycle prior to P.L. 101-510.

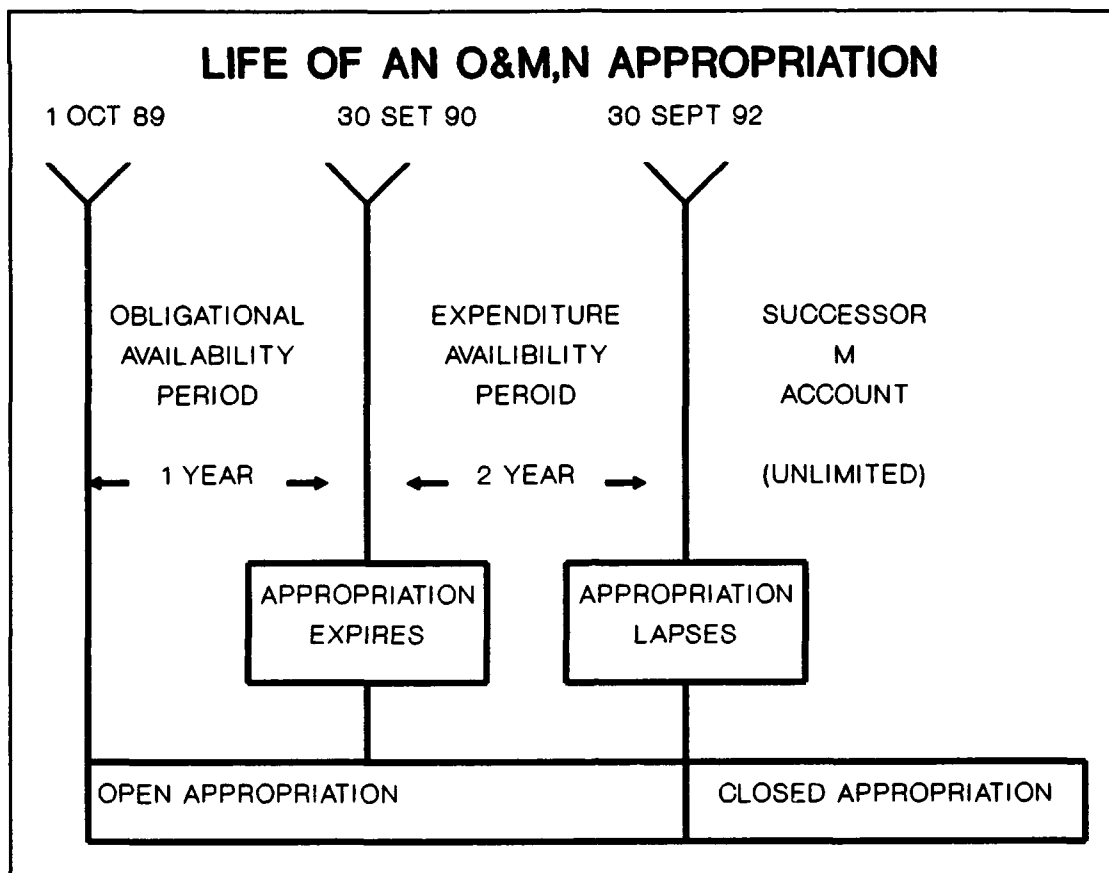


Figure 7.1 LIFE CYCLE FOR O&M,N PRIOR TO P.L. 101-510

C. FLOW OF FUNDS

The DOD receives funds from the Office of Management and Budget (OMB) in the form of appropriations approved by Congress. These appropriations provide budget authority to incur obligations and to expend funds from the U.S. Treasury. The DON is apportioned a share of the total DOD budget to execute its programs and to meet operational and administrative requirements. All Navy funds, except for RDT&E and Marine Corps accounts, flow through the Office of Navy

Comptroller (NAVCOMPT) which acts as the Responsible Office (RO) for these appropriations.

Specifically for the O&M,N account, NAVCOMPT (OP- 82) subdivides and distributes the funds to the various major claimants/AOs whose activities and forces are supported by this appropriation. The major claimants further subdivide the funds into Expense Operating Budgets (EOB) which are distributed two ways:

- (a) Shore activities, whose accounting is governed by NAVSO, P-3006-2 receive an EOB from the major claimant via the sub-claimant (type commander).
- (b) The EOB for activities whose accounting is performed under the provisions of NAVSO P-3013-2, Financial Management of Resources, Operating Procedures (Operating Forces), is provided to the Type Commander who in turn issues an Operating Target (OPTAR) to each fleet unit.

As indicated by Figure 7.2, budget authority flows down the chain of command from NAVCOMPT to the lowest level cost center. For example, USS Horne (CG-30), a cost center, receives an Operating Target (OPTAR) from Commander Naval Surface Forces, U.S. Pacific Fleet (COMNAVSURFPAC), an Intermediate Command Sub-Allocation Holder/Type Commander. COMNAVSURFPAC, in turn, receives an expense limitation from Commander in Chief, U.S. Pacific Fleet (an Administering Office/Major Claimant) who initially received a reallocation from NAVCOMPT, OP-82, the Responsible Office.

The DON managers at all levels of command maintain effective and positive control of these appropriated funds

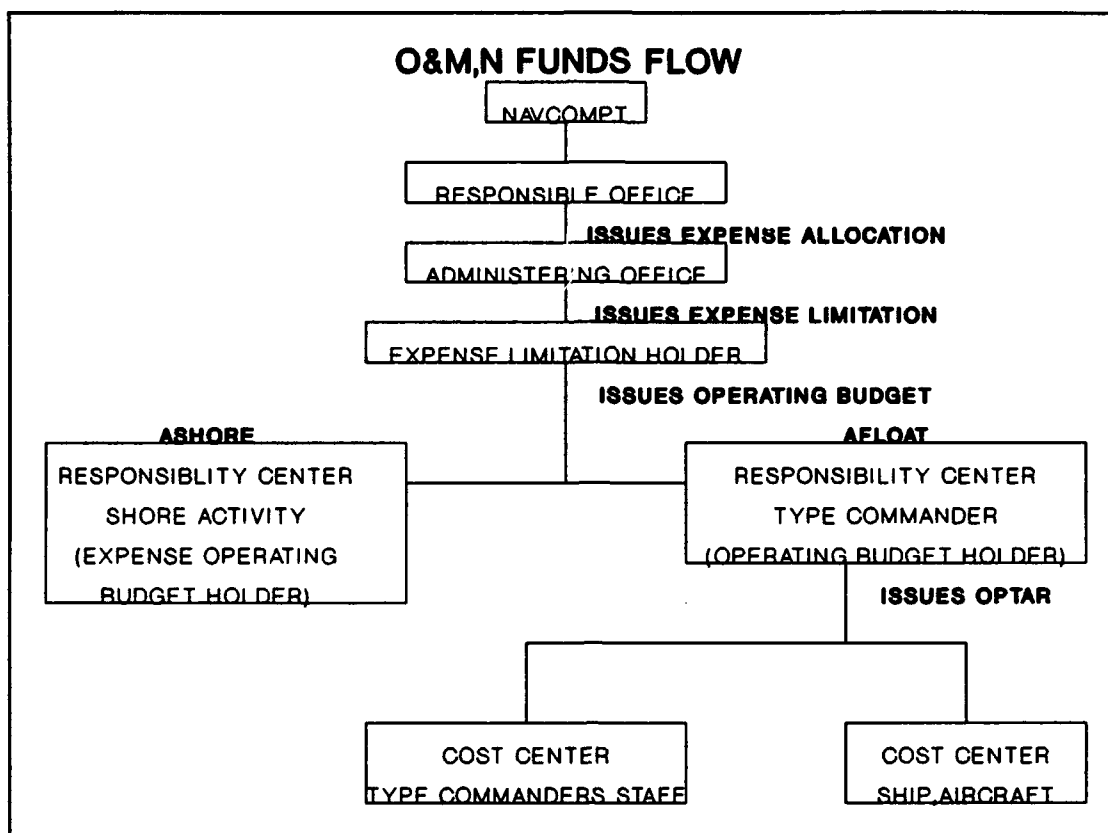


Figure 7.2 O&M,N FUNDS FLOW FOR DON

through the use of the financial management reporting system.

D. FINANCIAL MANAGEMENT REPORTING SYSTEM

The Navy maintains a formalized system by which it is able to track and account for O&M,N financial resources provided to and utilized by naval shore and afloat units. This system, entitled, the financial management system of an activity includes:

all systems, both manual and automated, that are used to collect, classify, analyze, and report data for financial decision making; process, control, and account for financial transactions and resources; and generate financial information in support of the agency mission. (OMB MEMO 85-10, 1985, p. I-2)

Thus, after funds are received by naval commands, records and reports must be maintained and evaluated to ensure strict compliance with the various financial administrative regulations and statutory fund limitations established by internal and external sources.

Prior to 1970, a dual-type reporting system existed to document the Navy's obligation authority reporting requirements and the disbursing/obligational accounting procedures. Figure 7.3 displays this traditional financial system in existence at the time.

In its simplest form, the system required two separate activities; an Authorization Accounting Activity (AAA) to perform consolidated accounting functions, and a Navy Regional Finance Center (NRFC) to perform disbursing functions. The NRFC functions included preparation and payment of public vouchers covering bills for supplies and contractor services. In addition, NRFC performed consolidation of summary records on civilian labor, material issue expenditures and submission of all financial transactions reports for reporting to cognizant headquarters. However, a major problem inherent in this dual system is the requirement to reconcile payments made and reported through one channel with accounting records established and reported through another channel. As a result, many payments may never be reconciled with specific activity accounting records.

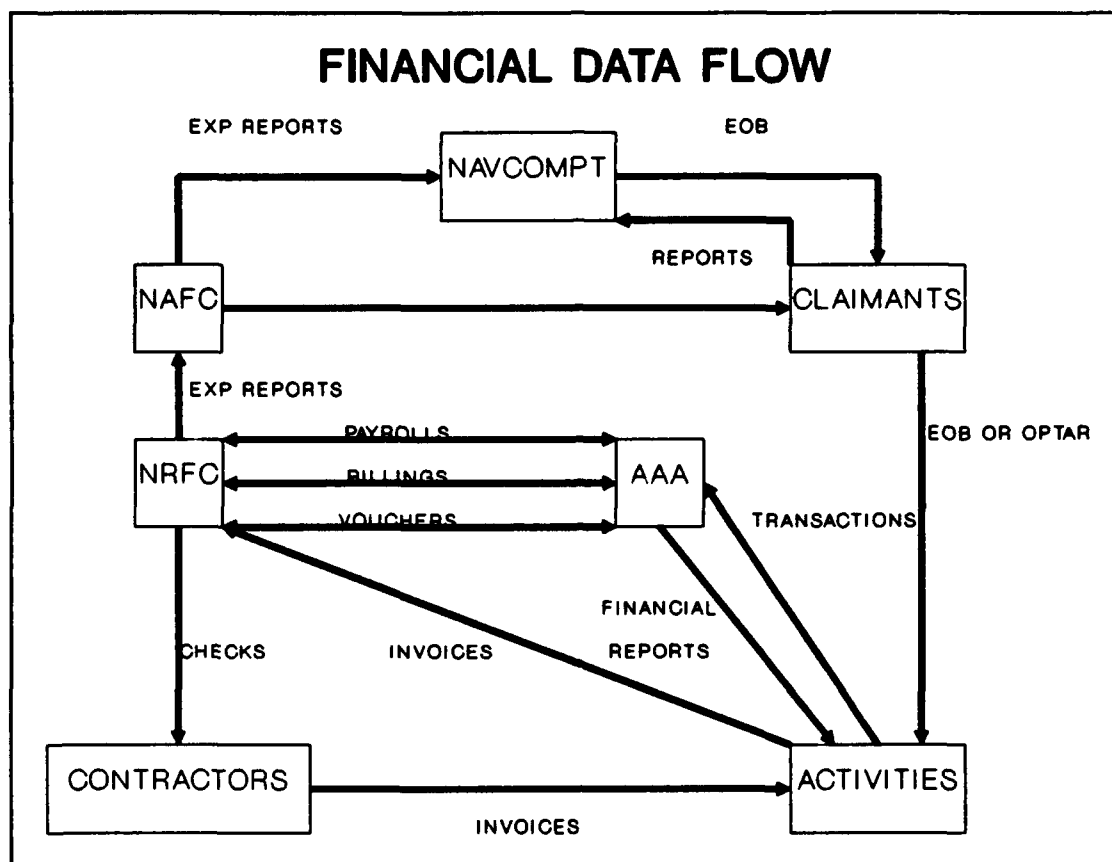


Figure 7.3 FINANCIAL DATA FLOW FOR DON

In the early 1970's, while the Navy was growing in size and complexity, various accounting and disbursing systems were developed to meet current informational needs and reporting requirements established by higher authorities. However, numerous problems surfaced with existing systems which prevented an efficient and effective operation. Factors such as the cost of maintaining and updating the various systems and the requirements for considerable maintenance of locally produced records (memorandum records) made the existing systems very expensive. There were also major discrepancies between the NRFC and AAA records which resulted in untimely

and often inaccurate reports being provided to the customer. These problems led to the establishment of the DON Financial Management Improvement Plan (FMIP) in 1974.

The purpose of the FMIP was to correct deficiencies in the Navy accounting system previously identified in various audits and to provide financial data which could better serve the needs of the Navy manager. However, the long term objectives of the plan focused on the integration of financial management, programming/budgeting, and accounting/reporting systems through the use of common data bases. To achieve the objectives of the FMIP, NAVCOMPT was tasked to coordinate the development and implementation of an integrated financial management system, one of which is the Integrated Disbursing and Accounting System (IDA). (Roundtree, 1985, p. 19)

1. DON INTEGRATED DISBURSING AND ACCOUNTING SYSTEM (IDA)

During the period 1970 - 1980, Navy development of an integrated financial system was initiated when six IDA systems were developed. By 1980, the emphasis shifted to the development of a single standard Navy IDA system. Later, the system was officially designated as the Integrated Disbursing and Accounting Financial Information Processing System (IDAFIPS).

IDAFIPS was to be the recognized standard Navy field level accounting, disbursing and reporting system. Under IDAFIPS, most NRFCs and AAAs would be consolidated into FIPCs.

It was to be installed at fifteen FIPCs located throughout the United States, Hawaii and at overseas sites. Thus, the FIPCs were responsible for providing accounting, disbursing, reporting and collection services for all activities.

The functions of the FIPCs were accomplished through the use of the data base created and managed by IDAFIPS. Data such as fund authorization, commitment, obligation and expense information enabled the FIPCs to integrate accounting and bill paying functions in processing Fund Administering Activities (FAA) or cost centers' financial transactions. Critical to IDAFIPS was the dedicated hardware suites procured and installed specifically to meet the application and processing requirements of IDAFIPS.

IDAFIPS incorporated four subsystems which comprised the Navy basic financial management system: (1) IDA Financial Management System (IDAFMS), (2) IDA Claimant Module (IDACAM), (3) IDA Financial Reporting System (IDAFRS), and (4) IDAFMS OPFORCES. IDAFMS, the first subsystem to be designed and implemented, formed the foundation for IDAFIPS and was to be the standard system for ashore activities. It is an on-line financial transaction system which provided summarized financial data and standardized reports to the IDA Claimant Accounting Module (CAM) and forwarded collection/expenditure data to the IDAFRS. IDACAM was designed to provide summary data to the Navy Headquarters Financial System (NHRS) and to serve the informational needs of the major claimants as well

as assist in the production of higher authority reports. IDAFRS was designated the official Navy system which classified, edited, balanced, validated and reported all disbursements/collections, material/labor expenditures and accounting data adjustments/collections within the Navy. FRS data is transmitted into the Centralized Expenditure/Reimbursement Processing Center (CERPS) for reporting to the Treasury.

IDAFMS Operating Forces (OPFORCES), the fourth IDAFIPS subsystem, was designed to perform all accounting functions for fleet units funded by the O&M,N and O&M,N Reserve appropriations. It was to provide all requisite financial data and cost reports to financial managers at the operating unit (Optar holder), the Type Commander (EOB holder), and to higher authorities. However, due to some commonality with IDAFMS, this system was being designed to fully integrate with IDAFMS to create a single accounting and financial system. This concept would enable shore based operating forces with on-line capability to update, modify and access records from the IDAFMS database while maintaining the capability for batch processing for the afloat forces. (NAVCOMPTINST 7000.39D, 1990)

Full implementation of IDAFIPS was initially scheduled for 1985. However, problems such as increased costs (\$90 million already expended), history of system design failures (in development over ten years), and continued schedule

slippage created significant delays in a fully operational system. Thus full system employment was not expected until 1992. (GAO Report No. IMTEC-89-20FS, 1989). Currently, an interim IDAFMS system, which runs on the UNIVAC 1100 hardware, is being utilized by operational forces.

Complicating the fate of IDAFIPS was the 1990 Budget Review Defense Management Report (DMR) result on the consolidation and improvement of DOD financial operations. The DMR indicated that numerous methods of accounting systems were in development and/or in operation throughout the DOD services which essentially performed the same accounting functions. It was also noted that IDAFIPS had critical functional deficiencies including non-compliance with DOD accounting standards. Therefore, because the DOD existing and proposed systems resulted in inefficient economies of scale, non-compliance with required accounting standards, and unnecessary costs, it was necessary that a standardized DOD accounting system be explored.

Consequently, the DMR recommended the consolidation and specialization of various accounting operations and functions under one DOD organization to enhance the Corporate Information Management (CIM)⁸ initiative; improve day to day

⁸CIM was intended to ensure the standardization, quality, and consistency of data from the DOD multiple management information systems, and to identify standard functional requirements for meeting DOD management information needs.

operations, and provide operating savings through the elimination of duplicate operations and functions. (PCC, 1991)

Subsequently, further funding for completing IDAFIPS has been canceled indefinitely. Therefore, until this consolidated DOD accounting system is in operation, DON operational activities will continue to utilize the accounting system partially established by IDAFIPS.

2. NAVY ACCOUNTING SYSTEM

DON maintains and utilizes thirteen major accounting systems supported by 122 operational accounting support systems. (PCC, 1991) The system utilized by operational commands is the Navy General Accounting System (NGAS). This system performs appropriation accounting and related functions at the major claimant and cost center levels for the Navy. As described by NAVCOMPT, in NGAS:

The two distinct levels of operation performed by this system (NGAS) are administering office and fund administrator accounting. Administering Office level accounting involves program management office accounting, budgeting support, and reporting for programs under specified subhead accounts. This level provides accounting control over field level through operating budgets and allotments. Fund administrator accounting involves operating budgets, allotments, and operating targets in a highly decentralized organizational environment. Fund administrators are involved in the receipt and execution of operating budgets and allotments provided by the administering office. Authorization Accounting Activities record Fund administrator transaction data and prepare the appropriate reports. The individual management structures, which are dictated by the missions of the organizations, and are often different, have specialized accounting and control information requirements. This has led to the development of a majority of the support systems, some of

which integrate disbursing and accounting. (NAVCOMPTINST 7000.39D, 1990, p. 109)

The operational accounting support system under the NGAS which performs accounting for all operating forces is the Fleet Resources Accounting Module (FRAM). This software package was developed in 1970 and is currently operational at two FIPCs: (1) Fleet Accounting and Disbursing Center, Pacific (FAADCPAC) in San Diego and (2) FAADCLANT in Norfolk. FRAM has been kept current as the needs of the activities changed or to accommodate new requirement such as change in report content or format levied by higher authority.

The FRAM supports the official accounting and reporting functions for the operating budgets and OPTARs holders. Obligation inputs are submitted by fleet personnel via detail transmittal letters three times each month. The FRAM then produces monthly status of OPTAR balances for fleet financial managers in order to manage and control their flow of funds. Reports are also generated for CINCPACFLT and COMNAVSURFPAC to monitor their subordinate commands and maintain positive control of these funds.

The DON financial management system is in need of relief. The IDAFIPS was to be the ultimate, state-of-the-art DON system to integrate accounting, disbursing and reporting functions at the operational forces level. However, until a single DOD system is fully functional, DON is continuing to

operate ADP hardware and maintain accounting systems that are over twenty years old.

VIII. IMPACT ON THE OPERATIONS ACCOUNT

A. INTRODUCTION

The implementation of P.L. 101-510 is in the initial stage for the Department Of Defense. Policy issues and problems are still being addressed and the full impact is not fully known on the operating forces. However, this chapter will focus on the DON interpretation of P.L. 101-510 and specifically where these interpretations affect the operational forces funded from the O&M,N account. It will analyze how the NAVCOMPT guidance on the elimination of the M account affects and impacts the forces afloat (ships), the sub-claimant (type commander), the FIPC, and the major claimant.

This chapter also explores some possible solutions to the problems arising from the elimination of the M account.

B. FORCES AFLOAT

Prior to P.L. 101-510, ship operating forces were required to maintain records for three years in order to account for all funds entrusted to them. This action required storing source documents, other locally produced records, and pertinent financial reports onboard ships. Since most ships carry automatic data processing systems, storing of this information is accomplished with disks or magnetic tapes. For non-automated units, manual records are maintained and usually

stored centrally in a storeroom(s) in boxes or file cabinets. These manual documents and records can occupy significant storage space onboard because of their cubic volume where space is very limited.

Based on enactment of P.L. 101-510, and commencing with FY 1989, O&M,N records of DON must be maintained for a total of six years. At the end of the one year obligational availability period, the account will retain its fiscal year identity and remain available for five years for the purpose of recording obligational adjustments. This action would entail an additional three years of recordkeeping which will have some impact on the afloat activity. For example, as evident on Table 8.1, in FY 1996, six years of records covering fiscal years 1991 to 1996 will be maintained onboard.

TABLE 8.1 STATUS OF OLD AND NEW BALANCES IN THE O&M,N ACCOUNT

	FISCAL YEAR BALANCE WILL EXPIRE					
	91	92	93	94	95	96
	UNEXP					
	EXP	UNEXP				
	EXP	EXP	UNEXP			
	EXP	EXP	EXP	UNEXP		
	EXP	EXP	EXP	EXP	UNEXP	
	EXP	EXP	EXP	EXP	EXP	UNEXP
	CLOSED	EXP	EXP	EXP	EXP	EXP

An informal survey of former and current Supply Officers who have served on ships indicate that the maintenance of records, especially the source documentations, for a total of six years (vice three) will exacerbate the limited storage space onboard. The afloat activities will likely continue to maintain hard copy documentation until a high degree of confidence is developed with the accuracy of the accounting system. Based on experience, financial reports received from FIPC are usually not timely or accurate, and so, local records are kept onboard until no further questions arise or the three years of mandatory recordkeeping has expired.

All shipboard space is usually fully utilized, and some Supply Officers have indicated that these new records may be stored in any space where they will fit. This may lead to potential shipboard safety/fire hazards if boxes of records are jammed into storerooms or other places where they may be stored. Thus, the major impact that P.L. 101-510 will have on the forces afloat is the problem of maintaining six years of recordkeeping onboard ships where storage space is limited. Six years of accounting records is significant especially for an account which historically has shown a 99% expenditure rate within the first three years of its appropriation life. Therefore, it is argued that there is limited need for the additional three years of recordkeeping. At a minimum, allowing for only three years to obligate and liquidate accounts will force the operators and financial managers to

aggressively validate and clean up the records. Also, with only limited transactions occurring during these last three years, those records should not be maintained just for the sake of auditability purposes in the future.

However, since P.L. 101-510 now requires records to be maintained for three additional years (years four through six), there should be a better system designed to consolidate, remove or destroy records that are closed (liquidated) during any of the five expired years. This system should be accessible to any activity and would address only those records for which there is no longer any question or any possible future transactions. Maintaining a central ashore facility for storage is certainly one solution to this shipboard problem. However, expenses such as facility maintenance costs, personnel manning costs, and storage costs of these records for over 200 ships make this option financially unattractive.

Another option would be to store all the data on disks, magnetic tapes, microfiche copies or some combination of each which could be transferrable to an ashore command. Two alternatives are provided:

- (1) Compact Disk Read Only Memory (CD-ROM) provides for storage of information on compact disk with enormous data storage capability (up to 600 mega byte of data on a single side of a single disk, 4.72 inches in diameter) using a personal computer readily available on most ships. Due to the

tremendous storage capacity and usefulness in audit trails, CD-ROM is highly desirable. However, one major drawback of the system is that once the information is stored in the disk it can only be read upon retrieval. No transaction processing or alterations may be made. Thus, the three additional years (years four through six) of recordkeeping may be stored on CD-ROM and read only on disks. It would not be possible to record payments or make adjustments to the data.

(2) Pattern Recognition and Imaging System for Material Management (PRISMM) is a state-of-the art imaging system that operates as a flexible front end (microcomputer) work station. It is designed to replace existing microfilm equipment with a more efficient and productive integrated document storage and retrieval system. PRISMM will store, index, and retrieve a wide variety of documents; thereby, diminishing paper and microfiche files, decreasing keystrokes and improving the quality of input data. The system can operate in either a single-user (i.e., stand alone) or multi-user (i.e., Local Area Network) environment. PRISMM was designed by Naval Supply Center (NSC), Norfolk and developed by Accurate Information Systems, Inc. PRISMM is currently in the final prototype stages at NSC Norfolk and NSC Pensacola. (Trimmer phoncon) Certainly this system should be explored for storing documents onboard or passing the information to an ashore activity for storage and retrieval once it is fully operational.

C. SUB-CLAIMANT (TYPE COMMANDER)

The elimination of the M account will affect the type commander in two areas: (1) Anti- Deficiency Act, Title 31 U.S. Code Section 1517 ("1517"), and (2) use of the current appropriation.

As mentioned earlier in Chapter IV, NAVCOMPT guidance requires that the Anti- Deficiency Act be applicable not only during the one year of obligational availability period but also during the five additional years of recordkeeping. Briefly summarized, Title 31 U.S. Code Section 1517 ("1517") prohibits any officer or employee from making or authorizing an obligation in excess of the amount available in an appropriation or in excess of the amount permitted by agency regulations.

Ships are allocated Operating Targets (OPTAR) which are not subject to "1517" legal limitations since the type commander holds that responsibility at a higher level. A potential problem lies in the five expired years where the anti-deficiency provision is still in effect. In fact, it remains a binding legal limitation until all outstanding obligations are paid. Thus, even the unexpended balance of the original appropriation can not be exceeded or a "1517" will have been committed.

The type commander has been tasked by the major claimant to receive all financial reports normally provided to ships to minimize the burden on the Optar holders with the three

additional years of accounting. (CINCPACFLT MSG, MAY 1991)
Therefore, the type commanders/Optar grantors will assume financial responsibility of the Optar holders after the second expired year (fourth year). Consequently, no reports or requests for research after the fourth year will be submitted by the FIPC to the Optar holders.

This requirement will require the type commander to dedicate specific tasks to the financial personnel to insure that the financial records received from the FIPC are complete and accurate for over 200 ships. Additionally, the financial personnel will be responsible for the three extra years of accounting/monitoring for the OPFORCES Optar. Discrepancies must be resolved with the FIPC or with the individual ships especially those units whose reports indicate potential "1517" violations. There is significant responsibility and work impacting the type commander from this new legislation. The impact is based on the additional workload required to do the OPFORCES Optar and the reconciliation of records to prevent "1517" violations.

To assist the type commander with this additional workload requirement, the number and frequency of required financial reports have been reduced by the major claimant. However, another possible solution to minimize the additional workload is to discontinue any financial record or report which requires no further transactions during the five expired years of reporting.

Another area where the type commander may be affected by the elimination of the M account is the use of the current appropriation to fund closed account adjustments. This provision was established by P.L. 101-510 to finance payments of valid unliquidated obligations after the five expired years have closed. The total of such payments from current funds is limited to one percent of the current O&M,N account, or the unexpended/unobligated balance of the original O&M,N appropriation, whichever is less.

Payments made against canceled (closed) accounts are tightly controlled and approval authority is required from NAVCOMPT (NAVCOMPINST 7040.37B). However, the use of current year appropriations does not provide additional funding. In other words, any legitimate obligations which require payments from current year funds must be funded by taking the money out of some other programs. No special reserve of funds is available for this contingency. Therefore, reprogramming funds as well as cutting programs completely to pay for these bills may cause a change in reprogramming/budget execution policy and procedures.

The outstanding problem with accounting for six years of activity is that no one really can predict how much is needed to fund these potential liabilities. However, the type commander must be thoroughly aware of this potential problem to prevent any "1517" violations. Significant price increases or valid upward adjustments taken by the ships must be

carefully reviewed, analyzed and managed by financial managers to preclude serious budget shortfalls in the future.

D. MAJOR CLAIMANT

In analyzing the NAVCOMPT guidance, one major issue which could have significant impact for the fleet CINC is the use of current appropriation to fund payments against the closed accounts. The major claimant will be issued Operating Targets by NAVCOMPT in each appropriation (including O&M,N) for payments against canceled accounts, which are subject to the one percent limitation. Additionally, the major claimant has approval authority to charge current funds for payments of less than \$100,000 as described in Chapter IV. However, no new funds are allocated to these Operating Targets. Therefore, any specific upward obligation adjustments, including contract and project order changes that involve additional work and cost, must be paid from existing funds previously allocated or programmed. As addressed at the type commander level, this could cause some significant budget execution decisions on how those funds are to be generated.

One area which may be affected by the new definition of project order changes is in the Maintenance of Real Property (MRP) ⁹ funding. (Ms Banta Briefing, 1991) Project orders

⁹ MRP includes labor and material costs associated with real property maintenance projects for land, buildings, structures and facilities.

(PO) are normally used when the work to be performed is a specific project or task with a specified completion date. MRPs are funded through the use of POs. Since they are date sensitive, the work and expenditures for POs can cross two fiscal years. Therefore, MRP can execute funds late in the fiscal year for work to be accomplished at a specified completion date sometimes scheduled in the next fiscal year. Additional work or cost increase adjustments required for completion of the MRP could previously be funded through the use of the M account. Under the new definition of PO changes this is no longer possible. Any PO changes requiring additional work or covering cost increase adjustments must be funded by current appropriations. Therefore, the MRP may see budget shortfalls in the future which will degrade the readiness of our naval bases and real property.

Reprogramming actions will be necessary to fund payments against closed accounts. However, the impact of these actions and the dollar amount required will not be known until sometime after 1993 when the M account is officially eliminated. The result may be a drastic reduction in the funding sources available, and conversely increasing pressure on present fiscal year funds which is not acceptable in this period of constrained resources.

One possible solution to minimize the potential use of current appropriation is to force the operating units to aggressively validate and liquidate the obligations before the

account is closed. Obviously, one way of ensuring that this is done is to require thorough evaluations during the command inspections. However, this may also be accomplished if the major claimant requires the responsible activity be held accountable for aggressively reviewing the accounts. Applying the "1517" responsibility to the operating forces, in addition to the type commander level, could minimize the amount of unliquidated obligations beyond three years. The potential for a problem to arise in years four through six would be significantly reduced.

A normal tour onboard a ship is usually 18-24 months for a Commanding Officer (C.O.) and 24-36 months for a Supply Officer (S.O.). Currently, there is no real incentive or liability provided by the upper echelon of command to keep those officers presently in charge accountable for an account that can be active for a six year period. Command inspections usually occur at 18 month cycle, so there is always the possibility of a C.O. and a S.O. not ever going through an inspection. Therefore, applying the Anti-Deficiency Act "1517" at the fleet level could provide some continuity in the accountability of these accounts. It may also be the motivator for fleet operators to liquidate obligations expeditiously and long before the account is closed.

E. FIPC

The elimination of the M account will have a greater impact on the FIPC than any other activity. But because the implementation process is at the initial stage, the full extent of the impact can not be quantified and may not be fully recognized until two or three years in the future.

The FIPC will continue to provide accounting, disbursing and reporting services to fleet activities as described in Chapter VII. At first glance, the additional three years of recordkeeping and reporting does not appear to be such a huge task to accomplish. However, personal interviews conducted with FAADCPAC personnel revealed that there will be unfunded costs and shortages of resources to be addressed before full implementation is achieved.

Foremost, is the fact that the current DON field accounting system has been operational with hardware and software packages designed and developed in 1970. Upgrade of the system to meet changes in reporting requirements and customer needs, have been achieved through quick-fix type methods. The major upgrade IDAFIPS, with significant delays and cost overruns, has been terminated. Therefore, the current accounting system continues to operate with the older, quick-fix updated system in place. As previously mentioned in Chapter VII, IDAFIPS is canceled indefinitely and the DON awaits development of a standardized DOD accounting system. Conservative estimates from field personnel indicate this

standard DOD accounting system may take eight to ten years to implement. In the meantime, old hardware and software systems continue to operate in the quick fix mode to meet changing requirements such as the new additional three years of recordkeeping.

With the elimination of the M account, the current software packages have been modified to accommodate the additional accounting and reporting requirements. Many of the changes needed to allow FY 1989 records and reports to transition into FY 1992 (when it would have lapsed into the M account) have been made and funded by the Defense Finance and Accounting System (DFAS). For FAADCPAC alone, the cost to make these changes in FY 1991 was approximately \$25,000.

To fully implement the changes for the other fiscal years ahead, initial cost estimates by FAADCPAC for OPFORCES Accounting only, indicates that another \$500,000 is required for FY 1992. The elimination of the M account will result in a projected need for 13 additional civilian positions to accommodate the workload associated with the three additional years of accounting for 20 Operating Budgets. Total annual costs of the GS 5/5 personnel and their 25% fringe rate is projected to be \$347,200. Additionally, ADP FY 1992 processing costs to operate through the Navy Computer and Telecommunication Station (NCTS), San Diego are estimated around \$160,200, an increase of approximately 30% from last year.

For Resource Management Accounting, which handles cost, allotment and appropriation accounting for DON ashore activities, approximately \$1,224,100 is needed to handle the requirements. This figure includes \$732,800 ADP processing costs and \$20,700 for ADP equipment and office support. For the Financial Reporting System (FRS), one additional personnel is required in FY 1992 to accommodate a 20% increase in the workload associated with validation and correction of accounting data. This requirement equates to approximately \$24,000.

A complete breakdown of the total estimated costs for FY 1992 to FY 1994 is provided by Table 8.2.

TABLE 8.2

COST ELEMENT	FY 1992 costs (\$000)	FY 1993 costs (\$000)	FY 1994 costs (\$000)
Civ Pers	\$ 843.2	\$1,285.0	\$1,285.0
Equipment			
ADP	\$ 20.0	\$ 20.0	
Office	\$ 15.2	\$ 13.5	
Machine Time	\$ 893.0	\$1,966.3	\$3,273.9
TOTAL COSTS	\$1,771.4	\$3,284.8	\$4,558.9

(Source: FAADCPAC, San Diego, 1991)

This table articulates the point that implementing the requirements of P.L. 101-510 is going to be costly. It is possible that not all costs are going to be funded and it is important to note that these costs are only estimates.

However, if these costs are close to being accurate for one FIPC, what would the total costs be for the entire DON?

Unfortunately, estimated costs for full DON implementation cannot be quantified at this time. However, in the long run, the individual activities will probably end up paying the bills. This means that some funds will have to be reprogrammed within the command to cover these unfunded requirements.

Finally, one remaining area that needs to be addressed is that of data accuracy. Although some improvements to the software packages have been and will be made to accommodate the changes, it does not guarantee that the information on the reports is more accurate. Yet, the financial manager (from the major claimant to the C.O. of a ship) is required to make important decisions such as reducing current year programs to pay for requirements that should have been paid four or five years ago.

In summary, the three immediate impacts facing FIPC today are (1) the availability of disk space at NCTS to handle the additional requirements, (2) limited resources to handle the additional workload, and (3) how to provide accurate information using out-of-date accounting system. Cancellation of IDAFIPS and the lengthy development of a new and standardized DOD accounting system is not going to meet the immediate needs of the Navy financial manager.

IX. CONCLUSIONS

A. INTRODUCTION

Chapter I through VIII have examined P.L. 101-510, DON interpretation of P.L. 101-510, and the impact of the new law on the Procurement and Operation and Maintenance accounts.

This chapter summarizes how the law corresponds to the current conditions facing DOD. This chapter will also offer conclusions and recommendations generated by the research. Conclusions are based on the information obtained from literature, interviews, and observations made during the research process.

B. SUMMARY

DOD financial management practices have been receiving considerable publicity. During the past eight years there have been more administration and congressional initiatives in the financial management field than at any other time; for example the Federal Managers Financial Integrity Act, Chief Financial Officer, Prompt Payment Act, Debt Collection Act, Balanced Budget and Emergency Deficit Control Act of 1985, and others. With the implementation of these policies, DOD financial and contracting managers will have substantial additional requirements to accomplish with little hope of obtaining additional personnel resources due to the declining

Defense budget. Since the Department of Defense has not given the proper level of attention to these areas in the past, the financial management community has now been directed by others on how to correct these situations. For instance, detailed reports on progress and compliance are required in order to accommodate congressional initiatives. The legislation to eliminate the M account was enacted with little foresight into the operational problems that would arise from this law. The M account provided a measure of flexibility for the instability presented by major weapon systems and ship overhauls. Nevertheless, Congress identified three major concerns about the M and Merged Surplus accounts: 1) the size of these accounts, 2) the lack of congressional oversight in the use of the accounts, and 3) the inadequate financial management controls in the management of the M and Merged Surplus accounts.

1) The size of the M and Merged Surplus accounts balance is an irrelevant issue. The balances in the M account represent continuing authority to draw on the U.S. Treasury from initial budget authority that is provided in an appropriation act. Therefore, if the balance accumulates there is no effect on the deficit. The cause of the problem lies elsewhere. As Mr. D.J. Vander Schaaf, Deputy IG DOD, pointed out to Congress,

But reducing the fund balance is not the real issue. The real problem lies in the weak internal controls in the accounting system in its totality, not just in the M

accounts and in the procedures that we use. Unless we fix the internal controls in the entire accounting process, as Sean O'Keefe has just explained, we are not going to get anywhere in addressing unliquidated obligations in the M accounts. We are going to continue to have a heck of a lot of accounting problems. (SCGA, Report No. 101-1085, 1990, p.44)

2) To Congress, the most important aspect of M account is the lack of oversight into cost overruns and the control of outlays which may be concealed by the M account process. Senator Roth asserted that,

Billions of dollars are legally available for spending even though not specifically authorized by Congress.

Federal agencies can use these accounts to write more contracts than Congress intends for a given year appropriation. It can be used to hide cost overruns; to circumvent the contracting process; and, to keep programs alive despite budget cuts. (SCGA Report No. 101-1085, 1990, p. 4)

Actually, this is the underlying motive for congressional action on the M account. In P.L. 101-189, Congress expanded its oversight of DOD management of expired appropriations. This legislation placed dollar thresholds for approvals when restorals involved adjustments requiring additional work. The OSD Comptroller has approval authority for amounts at or over \$4 million and the Senate and House Committees on Armed Services and Appropriations must approve amounts over \$25 million.

This measure seemed to be a viable tool in ensuring that large amounts of unobligated expired and lapsed budget authority were properly managed. In fact, in reviewing the 541 requests by DON from FY 1985 to FY 1990 for upward

adjustments from the Merged Surplus and Surplus accounts only two restorals were over the \$25 million threshold; \$25 million for cost growth on F/A-18 airframe and \$29.7 million for termination for default for reprocurement of Bancroft radios. During the GAO audit of the M account, the restoral for the Bancroft radios was deemed to be appropriate,

The resulting use of \$29 million of expired appropriations for the procurement of SINCGARS (Bancroft) is consistent with Comptroller General decisions regarding replacement contracts. (GAO NSIAD-91-156, 1990, p. 26)

The Air Force plan to use \$1 billion to fund the B-1 bomber is an anomaly and not the norm. The fact that it is a controversial program and the size of the contract adjustment served to ignite congressional concern. The existing system did insure congressional review would occur. Therefore, thresholds implemented by P.L. 101-189 were adequate to provide congressional oversight in the use of the Merged Surplus and Surplus accounts. Moreover, this legislation kept the degree of congressional micromanagement in the execution of funds to a minimum. Kenneth Adelman and Norman Augustine captured the nature of congressional oversight,

Many of the standards that the Pentagon auditors seek to enforce were not designed as part of an integrated management policy. Rather, these standards evolved in much the same way as common law; each time a problem occurred, a legislation was established to ensure that the particular problem would never happen again. Patches were plastered on top of patches until a huge mass of overlapping and sometimes even self-contradictory regulations were constructed. (Adelman, 1990, p. 175)

Therefore, P.L. 101-510, introduces another attempt to solve the symptoms of the problem and not the causes.

3) Congress was correct in assessing the financial management controls on the M account as being inadequate. The lack of fiscal year identity greatly weakened the ability to provide an audit trail for financial managers. However, the elimination of the M account should not be used as a surrogate for management. It is interesting to note that the financial management systems used in DOD, which have been criticized for their inefficiency and inaccuracy, can be entrusted to handle three more years of detailed recordkeeping. DOD financial managers are expected to deliver reliable data with inadequate systems and in some cases for questionable reasons. For instance, Congress' intent in eliminating the M account was to expose cost overruns and control outlays. However, there is no viable reason why O&M,N appropriations should be included. The management of records for those financial offices is a waste of resources without a credible return for the effort.

On the other hand, we can observe that the prevailing opinion in Congress and through most of DOD financial management community is that Program Managers should be able to accurately plan and budget for their acquisition programs. This is important so that there is a comprehensive baseline from which to evaluate changes. Nevertheless, there is an indication that "uncertainty" in development programs is not an inherent characteristic of the development process itself

but rather a symptom of poor management. In Congress, the budgeting of contingency amounts is often seen as a sign of poor management planning and the funds are frequently deleted. Though the M account may have its deficiencies, it served as a functional mechanism to allow for the flexibility that is needed for management of resources.

C. CONCLUSIONS AND RECOMMENDATIONS

While the total impact of this new legislation is not completely known, the following conclusions and recommendations are presented.

1. The outlay rates reveal that by the time the appropriations are prepared to lapse into the M account, the large majority of the funds in the appropriation have been expended. Also, the Naval Audit Service's audit of the M account revealed at least 60 % of the obligations were invalid. Therefore, with these two factors, the impact from old bills may not be as great as anticipated.
2. Contractors can expect to encounter increasing inflexibility from the government. Contracting officers are likely cautious about either seeking or agreeing to costly changes unless additional appropriations are made available.
3. Without the flexibility of an M account to fund increases in valid obligations, the acquisition planning process will have to be realistic against the funds available. When required, it must provide sufficient time to obtain additional resources.
4. With the declining budget and the elimination of the M account, the deobligation of funds has increased in importance. Excess funds can be lost if delayed contract closeout causes deobligations to occur after the funds have closed. Therefore, contract closeouts need to be accelerated and given direction and support from higher headquarters. Additionally, the quick

close-out method needs to be utilized whenever applicable.

5. New restriction on contract changes imposed by DOD will have a significant impact on the use of current appropriations. Viable adjustments to contracts due to program changes will adversely increase the need for current funds. Therefore, OSD should review the impact of the expanded definition for "contract change" and modify the criteria based on findings.
6. Upgrades of the DON field accounting system to meet changes in reporting requirements imposed by P.L. 101-510 are being attempted through quick-fix type methods. Unfortunately, these methods do not improve data accuracy. Adequate resources are not being provided to fund activity financial management needs. Therefore, financial managers are forced to make important decisions such as reducing current programs today to pay for prior year bills based on inaccurately processed information.
7. Communication between the ACO, PCO, comptroller, and the contractor need to be enhanced when dealing with the status of funds for respective contracts.

To most of Congress, the purpose and use of the M account was not understood and was seen as a threat to congressional oversight. Even the most routine financial process can be subject to scrutiny if congressional oversight responsibility is threatened. Therefore, this legislation attempted to correct a "perceived" problem by Congress.

The enactment of P.L. 101-510 eliminated the M account, and thus removed a flexible mechanism used by DON financial managers. The public law is specific and mandates additional requirements. Consequently, DON financial managers and contract administrators need to assess the issues identified in this thesis with well thought out strategies which will minimize the impact of this legislation.

D. AREA FOR FURTHER RESEARCH

Since the implementation of P.L. 101-510 is in its infancy stage, the total impact to financial and contracting managers is not clear. Therefore, following questions for further study could be examined.

1. How will new initiatives to improve accounting systems, such as CIM, in DOD enhance the management of expired funds?
2. How will P.L. 101-510 change contracting policy, especially in expediting contract close outs?
3. What is the impact of P.L. 101-510 regarding budget formulation process, especially for the full funding concept and contingent liabilities?
4. Will the reprogramming process be overburdened due to the elimination of the M account?

LIST OF REFERENCES

Adelman, Kenneth and Augustine, Norman, The Defense Revolution, ICS Press, 1990.

Bureau of National Affairs, "DCMC, DCAA to Accelerate Contract Closeout Pending Cancellation of M accounts." Federal Contracts Report, Volume 55, 11 February 1991.

Commander in Chief, U.S. Pacific Fleet message, Subj: Required Changes to Accounting/Bill Paying/Disbursing and Financial Reporting Systems for All DON Appropriations, 25 May 1991.

Committee on Governmental Affairs, U.S. Senate, Hearing on Control and Financial Management for Expired Appropriation Accounts. Washington, U.S. Government Printing Office, 1988: (101st Congress, 2nd session, Senate Report No. 101-1085).

Committee on Government Operations, U.S. House of Representatives, Budget and Accounting letter from Chairman, Commission on the Organization of the Executive Branch of the Government transmitting a report on Budget and Accounting, pursuant to P.L. 108, 83rd Congress, Washington, U.S. Government Printing Office, 1955: (84th Congress, 2nd session, House Document No. 84-192).

Committee on Appropriations, U.S. House of Representatives, Hearing, Department of Defense Appropriations for 1991, U.S. Government Printing Office, Washington, DC, 1990.

Department of Defense Instruction 7200.4(D), Subj: Full Funding of DoD Procurement Programs, 6 September 1983.

Federal Acquisition Regulation, U.S. Government Printing Office, Washington, DC, 20402, 22 August 1991.

"DMR Establishes New Positions at NAVAIR and other SYSCOMS", Golden Wings, Naval Air Systems Command Newsletter, 4 April 1990.

Harshman, Richard A., "Multiyear Procurement in the First Reagan Defense Budget", Armed Forces Comptroller, Summer, 1982.

Knight, Stephen D., and Ochs, Brian A., "Cancellation of Funds in Merged Appropriations Accounts: The New Law and Its Significance for Contractors", Contract Management, June 1991.

McNichols, Gerald, and McKinney, Bruce, "The Problem of Cost Growth", submitted to the 1983 Federal Acquisition Research Symposium, December 1983.

National Contract Management Association, "The Mystery of the M Account", Topical Issues In Procurement Series, June 1991.

NAVAIR Instruction 7040.13D, Subj: Definitions of Expenses and Investment Costs, 3 February, 1982.

NAVCOMPT Instruction 7040.37B, Subj: Guidance for the Administration of Appropriations After the Period of Availability, 30 September 1991.

NAVCOMPT Instruction 7000.39A, Subj: Department of the Navy (DON) Accounting Systems Compliancy and Implementation Plan, 11 April 1990.

Naval Postgraduate School, Practical Comptrollership, text for Practical Comptrollership Course, Monterey, CA, January 1991.

NAVSEA Instruction 7000.12, Subj: Extension of Obligational Availability for the Shipbuilding and Conversion, Navy (SCN) Appropriation, 6 September, 1984.

Department of the Navy, NAVSO P-3013-2, Financial Management of Resources: Operating Procedures (Operating Forces), October 1990.

Office of Management and Budget Memorandum 85-10, Subj: Financial Management and Accounting Objectives, 15 March 1985.

Roundtree, J.S., The Integrated Disbursing and Accounting Financial Management System (IDAFMS): An Overview of the System, its Implementation, and the Employment of Microcomputers in Support of IDAFMS, Master's Thesis, Naval Postgraduate School, Monterey, CA, March 1985.

Shields, Pat, Interview, Naval Air Systems Command, F/A-18 Program Procurement Contracting Officer, Crystal City, VA, 27 August 1991.

Sia, Richard, "'Slush Fund' sparks anger, action on Hill", Baltimore Sun, 10 June 1990.

Smithey, Jerry, Interview, Naval Sea Systems Command, Director Financial Management Policy, Crystal City, VA, 27 August 1991.

Speech by Vice Admiral Mauz, USN, Deputy Chief of Naval Operations, Navy Program and Planning, as a Superintendent's Guest Lecturer, Naval Postgraduate School, Monterey, CA, 27 August 1991.

Speech by Ms Banta, Deputy Comptroller, Commander in Chief, U.S. Pacific Fleet, before financial management students, Naval Postgraduate School, Monterey, CA, 12 November 1991.

Telephone conversation between Thomas Herlihy, Division Director, Naval Audit Service Capital Region, Crystal City, VA and the authors, 30 August 1991.

Telephone conversation between Elzora Trimmer, LOGMARS Project Office, Naval Supply Systems Command, Crystal City, VA and the authors, 5 November 1991.

United States General Accounting Office, Report GAO/FGMSD 80-10, Defense Accounting for Its Contracts Has Too Many Errors: Standardized Accounting Procedures' Are Needed, 9 January 1980.

United States General Accounting Office, Report GAO/NSIAD-86-64, Management Review: Progress and Challenges at the Defense Logistics Agency, 7 April 1986.

United States General Accounting Office, Report GAO/AFMD-88-63BR, Financial Management: Responses to 17 Questions, 20 June 1988.

United States General Accounting Office, Report GAO/NSIAD-89-209, Strategic Bombers: B1-B Program's use of Expired Appropriations, 5 September 1989.

United States General Accounting Office, Report GAO/IMTEC-89-20FS, Navy's Efforts to Develop an Integrated Disbursing and Accounting System, 8 February 1989.

United States General Accounting Office, Report GAO/NSIAD-91-156, Expired Appropriations: New Limitations on Availability Make Improved Management by DOD Essential, 18 July 1991.

Waelchli, Fred, "Building the Acquisition Program Budget-A Conceptual Approach" Armed Forces Comptroller, Fall 1984.

INITIAL DISTRIBUTION LIST

- | | | |
|----|--|---|
| 1. | Defense Technical Information Center
Cameron Station
Alexandria, VA 22304-6145 | 2 |
| 2. | Library, Code 052
Naval Postgraduate School
Monterey, CA 93943-5002 | 2 |
| 3. | LCDR Ben A. Fegurgur
223 G Ave
Coronado, CA 92118 | 3 |
| 4. | LT Anthony F. Marinello
424 Chisholm Drive
Virginia Beach, VA 23452 | 3 |
| 5. | Professor Richard A. Harshman
Department of Administrative Sciences
Code AS/Ha
Naval Postgraduate School
Monterey, CA 93943-5002 | 1 |
| 6. | Professor Richard B. Doyle
Department of Administrative Sciences
Code AS/Dy
Naval Postgraduate School
Monterey, CA 93943-5002 | 1 |
| 7. | Mr. Anthony A. Tisone, Jr.
Office of Navy Comptroller
Director Resource Allocation & Analysis, NCB-3
CM2 606
Washington, DC 20350-1100 | 1 |